

[Securities Regulation Daily Wrap Up, INVESTMENT ADVISERS—III. App.: Court says indexed annuities are not securities, reverses adviser sanctions, \(Aug. 1, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Amanda Maine, J.D.](#)

The Illinois Court of Appeals reversed an order by the Secretary of State that revoked the registration of an investment adviser and imposed a \$330,000 fine for securities fraud. The court found that the annuities at issue were not "securities" under Illinois law and that the adviser's conduct was not fraudulent (*Van Dyke v. White*, July 29, 2016, Turner, J).

Annuities transactions. A hearing officer of the Illinois Department of Securities found that the adviser recommended and sold 31 transactions to his senior citizen clients that resulted in the surrender of traditional fixed annuities in order to purchase equity-indexed annuities. Most of the new indexed annuities featured higher fees while starting new surrender penalty periods. The Illinois Secretary of State issued a final order adopting the hearing officer's recommendations, finding that the indexed annuity transactions were unsuitable for the clients and that he had defrauded his clients. The adviser was fined \$330,000 and his investment adviser registration was revoked.

On review, the Illinois Circuit Court affirmed the Secretary's order. The adviser appealed to the Court of Appeals, alleging that the annuities in question were not "securities" under state law and that the Secretary's finding was contrary to the preponderance of the evidence. The North American Securities Administrators Association [filed](#) an amicus brief supporting the Department's findings.

Indexed annuities are not securities. The appeals court agreed with the adviser that the Department of Securities lacked jurisdiction over the indexed annuities transactions because they are not securities under the Illinois securities law. The court noted that the Illinois statute excludes from the definition of a security a face amount certificate in the form of "an annuity contract issued by a life insurance company authorized to transact business" in Illinois, a category under which the annuities in question fall. By the plain language of the statute, they are not securities under Illinois law, the court concluded.

The court also criticized the Department's order for its lack of any reasonable explanation for its determination that an indexed annuity is a security. In addition, the court noted that the Department was attempting to define securities to include indexed annuities in a disciplinary proceeding, when the Department should instead go through the rulemaking process and be subject to comment and challenge.

Findings of fraud. The appeals court also found that the Department failed to prove by a preponderance of the evidence that the adviser committed fraud. The Secretary had found that the indexed annuities were not suitable investments for the clients at issue. The court pointed out that the Department had no rules or written criteria to evaluate annuities that would indicate its expertise in the area, and contrasted this lack of criteria and expertise to that of the Department of Insurance, which has detailed regulations addressing suitability factors relating to annuities.

The court also noted that the Department's "evidence" that the adviser fraudulently induced the clients to purchase the replacement annuities consisted only of the surrender charges and the market value adjustment, without consideration as to whether the new annuities were suitable based on each client's individual needs and financial condition.

Finally, the court noted that none of the 14 clients who testified complained about the transactions and had testified that they were aware of the fees and surrender charges described by the Department. The court

observed that one client in particular testified that the adviser had explained the fees and surrender penalty, and said that the performance of the indexed annuity he had purchased more than made up for the costs of switching from the fixed annuity.

The case is [No. 4-14-1109](#).

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Companies: North American Securities Administrators Association, Inc.

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