

In Profile: David Macchia ▼



David Macchia

president and CEO of Wealth2K, an innovator in web-based technology and digital media for the financial services industry. He has been involved with EIAs since their inception in 1995 and is perhaps now the lead consultant to the major U.S. annuity manufacturers, providing marketing and educational tools, including compliance protocols, for these products.

Macchia spoke with LIFE&Health Advisor about the genesis of 151A, the fallout from the now infamous Dateline NBC exposé that excoriated the EIA marketplace and the battle now set for the very definition of these products.

L&HA: What is 151A really all about?

DM: The proposal is looking to categorize most equity-indexed annuities (EIA) as securities, which I would say is both tragic and beneficial. It's tragic in the sense that EIAs, in my view, are not securities. They are just not. But it is also tragic in that the EIA industry allowed such poor sales practices, issuing complex and unfriendly annuity contracts. They made their own beds, so to speak and creat-

ed a monster that invited the SEC to intervene in the name of consumer protection.
On June 25, the Securities and Exchange Commission proposed rule 151A which would, in effect, require certain equity indexed annuities, fixed instruments in nature, to be registered as securities. It set a response deadline, September 10, for which parties from all industry and regulatory corners could contribute comment. [As we go to press no official announcement has been made.]

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L&HA: That appears to be a good argument in favor of 151A doesn't it?

DM: Well, this is where the benefit to the industry can be found, and not in the short term but for the long term. If EIAs do become securities, and I stress the word "if", this would inevitably force the costs of EIAs down and the value of their value to consumers upward, and that will set up potentially, significant growth for the product. This is especially true for boomers who are approaching retirement and need to both protect retirement assets and maintain upside growth potential.

L&HA: How will making EIA securities reduce cost and increase value?

DM: Because a registered product wouldn't be able to be as high-cost and as utterly complex and arguably misleading, as some of the most offensive annuity contracts were.

L&HA: The language of 151A argues that "payments to the purchaser based upon performance of a securities index" clarifies the definition of a security. That seems to be black and white, but hadn't the SEC in the late 1990s declared then that EIAs were not securities?

DM: Well, I would not say that it is black and white and I would say that the rule does anything but clarify the issue. Essential to the notion of a fixed annuity generally, and to an indexed annuity specifically, is the protection from investment risk of a customer's principal sum. It is the calculation of future interest that is linked to the performance of an investment index. This is where the SEC is making its rationale, and it is where the insurance industry, really through no fault of its own, allowed the camel to get its nose under the tent. This goes back a few years, when interest rates dropped precipitously and the 10 Year Treasury dropped to around three percent. Insurance companies lowered the guaranteed interest rate on EIAs from what was generally three percent to what is perhaps now one percent. So, by taking a lot of the guaranteed feature away from the product, making the guarantee very nominal, it allowed the SEC justification to claim that there really isn't much guarantee involved, and what you are creating is a contract that functions as a security.

L&HA: If interest rates rise, wouldn't insurance companies increase the guaranteed rate? Is the SEC being disingenuous?

DM: If interest rates rise, insurance companies do not have a lot of incentive to increase guaranteed rates, which they have to honor for decades or lifetimes. What I find most interesting about this is the

way 151A is written. I can't determine if it is very sloppily written or very cleverly written. It's open to interpretation. But by extension, the language threatens many other types of annuity contracts, and possibly even life insurance.

L&HA: How so?

DM: Because it seems to say that whenever the linkage to the interest crediting, whenever the reliance upon interest crediting, is primarily tied to an equity index, then de facto you have a security. So that threatens indexed UL, it threatens some ordinary fixed annuities...it threatens a lot of things. This is why the industry has responded the way it has in opposition, even areas of the industry that are not related to indexed annuities?

L&HA: Who benefits from this proposal?

DM: That depends on your perspective. The insurance industry would say that no one benefits. The SEC, and by extension the broker/dealers, would say that consumers benefit. I think what everyone should be focused on is that consumers should be better informed, they should be better educated and they should be provided contracts that are not misleading and that offer a fair value. In order to achieve this, I believe that you do not have to reclassify fixed annuities as securities. What's important to me is that we get to where we are achieving that goal.

L&HA: What's your sense as to where this proposal will go?

DM: This is speculation, but my sense is that the SEC will hold to its position and the EIA industry will fight aggressively for its position, paving the way for a battle that could go all the way to the Supreme Court.

I have felt all along that the fact that SEC Chairman Cox sought to focus on the Dateline NBC program that unveiled a sting operation focusing on EIA sales practices was a significant fact. The perception of seniors being treated poorly and having that story broadcast nationally, was more damaging to the industry than was perceived at the time, and that perception continues, perhaps more so now. I am proponent of using more and better technology to train advisors to better sell their product, so it is quite ironic to me that the disposition of this debate may come down to how much television a Supreme Court judge watches.

L&HA: If it gets there, what is the crux of the argument?

DM: I am not a lawyer, so I am not certain how the legal argument will be presented. But, I would imagine that the arguments will come down to one side arguing that an EIA is clearly not a security because its principal is guaranteed, with a minimum interest credited on a guaranteed basis. The other side will argue that if it walks like a duck, and talks like a duck...well you get the point.

L&HA: You can imply, reading the language of 151A, that arguments may fall into jurisdictional territory. Could this debate possibly be argued on federal versus state jurisdiction?

DM: If there is a power struggle between federal and state regulation, it is not explicitly stated as such, but there well could be some elements of that. Obviously, the SEC is aware that the confluence of poor sales practices and of complex and high cost indexed annuity contract designs came on the watch of state regulators, and that could certainly bolster its argument.

L&HA: Isn't there legal precedent, such as the VALIC decision, that would support the argument that EIAs are not securities?

DM: The insurance industry will argue that those court cases have already decided the issue, but the SEC is arguing that those cases are not relevant in today's world of indexed annuities. Again, the more ominous implication is that by extension 151A can be viewed as a short step to categorizing many other forms of insurance as securities. ❖

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