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CLIENT BULLETIN

Fixed Annuities Are Not "Securities" Under Illinois Law

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The insurance producer and registered investment adviser in *Van Dyke v. White*, 2016 IL App (4th) 141109-U, recommended the liquidation of more than 30 indexed annuity contracts issued to clients by life insurance companies and replaced them with other indexed annuities. Citing surrender charges totaling more than $180,000 and commissions that were nearly equal to those charges, the Illinois Secretary of State, which regulates investment advisers in Illinois, concluded the adviser violated the Illinois Securities Law of 1953 ("Act"), 815 ILCS 5/1, et seq. Specifically, the adviser, Van Dyke, allegedly engaged in securities transactions prohibited under the Act and violated statutory duties owed to his clients as a registered investment adviser. *Van Dyke v. White*, 2016 IL App (4th) 141109-U, ¶15. The Secretary revoked Van Dyke's investment-adviser registration, permanently prohibited him from offering or selling securities in Illinois, fined him $330,000, and ordered him to pay the costs associated with the Secretary's investigation, including the fees of its expert witness. *Id.* at ¶15.

Relying on a straightforward construction of the Act, an Illinois Appellate Court panel found that indexed annuities issued by life insurance companies are not "securities" for purposes of the Act. *Id.* at ¶25. As further support for that construction, the court observed that if any type of annuity was likely to be considered a security, it would be a variable annuity, yet the Illinois General Assembly specifically declared those annuities fall under the sole jurisdiction of the Illinois Department of Insurance. *Id.* at ¶26. "It would make little sense," the court explained, "for the legislature to place variable annuities out of the reach of the Securities Department but then subject annuity products such as indexed annuities to securities regulation." *Id.* Consequently, the Secretary's determination that Van Dyke engaged in prohibited securities transactions under the Act was erroneous.

The court also concluded the Secretary erred in holding that Van Dyke violated duties imposed on him as a registered investment adviser by, among other things, engaging in fraud. *Id.* at ¶34. The court noted that a dually-registered individual like Van Dyke was capable of acting simultaneously as a registered investment adviser under the Act and as an insurance producer under the Insurance Code and, in those circumstances, was subject to the legal duties imposed by each regulatory scheme. *Id.* at ¶31. Thus, even though the transactions at issue were insurance-related transactions (as opposed to securities transactions), if Van Dyke was acting in part as a registered investment adviser, he would owe clients the duties imposed by the Act. The court agreed the record supported the Secretary's finding that Van Dyke acted as an investment adviser in connection with the transactions at issue. *Id.* at ¶31. But the Secretary's determination that Van Dyke engaged in fraud was premised on a regulatory standard of conduct that had no bearing on sales of annuities to insurance clients. *Id.* at 38. And the Secretary's assertion that the transactions were so unsuitable as to constitute fraud elided any consideration of the clients' unique needs and financial status, which are critical to any suitability analysis. *Id.* at ¶41. In light of those deficiencies, the court held the Secretary's finding of fraud was arbitrary, capricious, and against the manifest weight of the evidence. *Id.* at ¶¶37, 43. Accordingly, the Appellate Court reversed the Secretary's final order against Van Dyke.

If you have any questions about this Client Bulletin, please feel free to contact any of the attorneys listed or the CMN attorney with whom you regularly work.

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