S7-22-97 42
S7-14-08 770

THE
MAXFORD
COMPANY

August 2, 2008

RECEIVED
AUG 11 2008

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-6009

Re: File NO. S7 – 22- 97

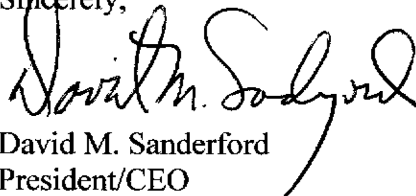
Sir:

This letter provides a response (in triplicate, attached hereto) to the Commission's request (Release No. 33 – 7438) for public "…comments on the structure of equity index insurance products, the manner in which they are marketed, and any other matters the Commission should consider in addressing federal securities law issues raised by equity index insurance products."

These comments are provided by me as a private citizen who has observed the entire history and development of the above referenced products from two different perspectives: first, as an "industry insider" with senior management positions in legal, compliance, and marketing areas for insurers and their distributors, and secondly, as an expert witness in securities and financial litigation. In my consulting practice I have been retained by the New York Stock Exchange to provide evaluation and testimony regarding "annuity sales abuses" in contested enforcement actions against registered representatives.

I believe this is an important effort the Commission is undertaking and would be pleased to make myself available for questions and/or testimony on subjects related to equity index insurance products.

Sincerely,



David M. Sanderford
President/CEO

Attachments

5502 Flag Stick Dr.
Granbury, Texas 76049
Phone: 817-573-6765
Fax: 817-573-6741
E-mail: maxfordco@aol.com

S7-22-97 42

Comments
(with analysis)

Of

David M. Sanderford, J.D.
The Maxford Company

To

Securities and Exchange Commission

Pursuant To
Release No. 33 – 7438

Regarding
Equity Index Insurance Products

August 2, 2008

Preliminary Questions and Answers

Is there a current problem with equity index insurance products?

Yes. It is apparent that the SEC has embarked on this project, requesting public comments, not simply as an intellectual exercise but because the Commission has observed the tsunami wave of customer complaints, state enforcement investigations, and private litigation that has gained widespread publicity.

What is the nature of this "problem"?

The substance of the problem is that many thousands of United States citizens are annually purchasing Billions of dollars of equity index insurance products, (with inadequate regulatory oversight and by use of complex and misleading representations) that are inappropriate for their age and financial circumstances. The primary risks associated with these products are generally undisclosed to the customers.

Is State regulation of insurance adequate to address this problem?

No. With but few exceptions, state insurance regulation is dominated by the interests of insurance companies, and agents. To the extent that "public protection" is addressed by state agencies it is typically directed at "corporate financial adequacy" rather than consumer issues. Without an actual "theft or obvious fraud" by an agent, consumer complaints are routinely dealt with by making an inquiry of the company and agent, and closing the file upon receiving their "denial" of responsibility". Policy form approval processes are often manipulated by insurers to escape effective review, and to gain "approval" of incrementally more complex, illiquid, and costly equity index products than those extant at the creation of Rule 151.

Can the Commission effectively regulate (unregistered) equity index annuity distribution through its jurisdiction over FINRA registered firms and representatives?

No. While FINRA (and SEC) can control standards relating to the sales activities of registered firms and representatives, relating to equity index products; it should be recognized that most of the EIA sales occur through licensed insurance agents who deliberately hold no FINRA registrations.

Can the insurance companies (issuing the equity index products) be held effectively responsible for the sales activities of their appointed agents?

Not likely, without treating equity index products as registered securities. The most common business plan used in the distribution of equity index products is

the "independent" agent model. Typically, the agent agreement between the insurer and the agent, gives the agent the total responsibility to determine that the product is appropriate for the customer (they don't generally use the term "suitable"). When a "problem" arises, the insurer points in the direction of the agent, and all too often that agent is gone – gone – gone.

What is the likely motivation of the insurance companies and agents to sell equity index products?

Corporate and individual greed is the likely motivation. This "common EIA enterprise" between an insurer and a *complicit* agent to sell equity index products is one of the very few opportunities that can produce millions of commission dollars to an under trained and poorly educated person (the agent), in a very short period of time -- without any substantive standards relating to professional conduct that may restrict their tactics and results.

What does the "common enterprise" referred to above usually consist of?

This "common enterprise" is most often made up of the following components.

- High commission product. Traditional fixed-rate annuities (without any bonus feature) relying on retail distribution channels would typically pay total commissions in the 5-7% range, variable annuities 6-8%. Equity index annuities often pay commissions as high as 10-18%.

- Multi-level marketing. Most insurers have a "commission hierarchy" that spreads this high equity index commission among agents, general agents, recruiting agents, referring agents, sub-agents, co-agents and other vague and multiple categories – most of whom have never talked to or know the customer (think "pyramid"). Significant money is made from the recruiting of agents, rather than the marketing and sale of the product itself. Audits would show that many individuals in a commission hierarchy are not appropriately licensed for these commission payments.

- Target seniors. "Free lunch" seminars are epidemic where older consumers are gathered with "come-ons" that are of specific interest to their demographics – living trusts, Medicare, social security, etc.

- Predatory sales practices. These agents in this enterprise often cloak themselves with the appearance of expertise to gain the trust and confidence of older clients and to have their recommendations accepted without undue scrutiny. The agent will use obscure (and

usually "purchased") titles that signify expertise with "senior issues", have books ghost written that list them as authors or contributors, host radio and television shows that pretend to offer "objective" investment advice, and advertise dubious third party testimonials. In Texas, and in the deep South, religious ties are unscrupulously used to gain trust – an agent invoked prayer often preceding the signing of transaction documents.

- Bait and switch to equity index annuities. Without other products to offer, the discussion with the senior client inevitably leads the agent to recommend these complex, illiquid and costly products to almost every prospect, regardless of differences in their ages, incomes, expenses, taxes, or investment objectives.

ANALYSIS

Equity Index Annuities ("EIAs") – Technically these products are a sub-category of fixed-rate annuities. However, EIAs are marketed and sold much differently than traditional fixed-rate products. The request for comments has described the various and complicated methods insurers use to calculate interest rates that have some "connectivity" to equity market performance. These methods are varied and often are combined with vesting and market value adjustment processes that further obscure (from the customer) the true nature of the product – and the risks associated with its purchase and ownership. I will not attempt to lengthen this paper with any substantive comparison of policy features, others will do so. However, I will make reference to several different interest rate calculation methods to highlight specific points that I will discuss.

Fixed-rate annuities were traditionally (from the early 1970s when the NYSE first allowed brokers to sell insurance) considered the risk equivalent of a fixed-income asset (bond), and variable annuities the risk equivalent of an equity asset (stock). Substantive interest rates were guaranteed in advance for fixed rate annuities in accordance with predictions (by insurance company management) of the insurer's General Account earnings ability. The variable annuities were ensconced in Separate Accounts (a legally defined term that "separates" those assets from any General Account liabilities) that were invested according to a specific (equity, often long term capital appreciation) investment objective. It is this Separate Account that was the entity registered as the issuer (along with the insurer) of the "variable annuity security".

Eventually, creative insurance company executives hatched the idea of a product that had "the best of both worlds" – guaranteed interest rates that reflected upward market results BUT no downside risk. They apparently decided to make commissions for this new product about 50% higher than either fixed-rate or variable annuities. AND, because this product will not be registered, they could complete the transaction without having to disclose the amount of these commissions to the customer.

I will not attempt to describe or evaluate the complex internal investment strategies that companies have formulated to support their interest rate calculation methods (this is beyond my competence) except to make one comment that I feel is important. All insurers issuing EIAs create a segregated asset account to apply their specific strategy that (while technically is part of the company's General Account) is for all other purposes a separate (small "s") account (small "a") in the same practical fashion as a Separate Account designed for variable annuities.

I predict that the Commission will (as before) be swamped with comments from parties that have a vested interest in the continued manufacture (insurance companies) and distribution (agents and their agencies) of equity index annuities. By comparison, there

will be few comments on the behalf of consumers. The obvious objectives of the insurance companies and agents will be to continue the application of Rule 151, with as little change as possible, to their EIA products and profits.

Rule 151 – The stated purpose of this rule was to establish reasonable "safe harbor" criteria, which if met by an insurer with respect to a specific annuity product, would not require that product to be registered under the '33 and/or '40 Acts. Explicit in this non-registration is the understanding that the anti-fraud provisions of the '34 Act would not be available to protect consumers.

In my opinion, it would be a mistake of the gravest order to treat the present Rule 151 elements as "reasonable criteria" upon which to build a somewhat more comprehensive standard. While I cannot speak for the Commission's historical point of view, it was largely felt by the insurance industry at the time of the original promulgation of Rule 151, that a great victory "over regulatory oversight" had been won. The phrase used often in insurance circles was "safe haven" not "safe harbor".

It is my opinion that Rule 151 needs to be replaced entirely, rather than being changed marginally to reflect some effort at "updating". Not to be unkind, but the criteria used in Rule 151 are practically worthless for the Commission's intended purpose. The public is ill served by the present state of affairs that has left them relatively defenseless against a juggernaut of insurance company legal "muscle", and the predatory sales techniques of "independent" insurance agents. This unholy partnership operates with almost no effective regulatory oversight, and many thousands of seniors have lost much of their retirement nest eggs to the EIA sales representation – "Participate in the market, and never lose money."

Let's take a brief look at the present criteria of the Rule 151 safe harbor.

Applicability of State Insurance Regulation

Since 100% of all organizations issuing annuity policies are insurance companies regulated by the various states (find me one that isn't), meeting this standard is a fore gone conclusion. Enough said.

Investment risk

Acknowledging the VALIC and United Benefit cases, it would appear that the Commission has historically yielded on this point to any situation where the product is not tied to a Separate Account (as opposed to a separate segregated asset account that is captured within the company's General Account, see other remarks).

The Commission is mistaken (in my opinion) in referring to the common 3% interest on 90% of the purchase payments as a "floor guarantee". This "3% on 90%" threshold is (unless I misunderstand) the typical State's calculation basis necessary to meet its standard non-forfeiture values for this classification of annuity. The insurer's contractual guarantees are different although the policy may also make reference to the "3% on 90%". The Commission is also mistaken in its belief that the "3% on 90%" means that the insurer has made a "typical 10% deduction" for sales and other expenses. The amount of "acquisition expenses" (the biggest portion of which is made up of commissions) varies wildly between companies and may be as high as 20% of the purchase payment(s). No matter the actual level of commissions paid out by a specific company, the commissions are unrelated to the "3% on 90%" calculation.

I have seen lower guaranteed values than the above. If you will do the simple math of applying 3% interest compounded yearly to 90% of a purchase payment, you will see clearly that the value doesn't "cross over" (or exceed) the original investment until sometime in the 4th policy year. I have attached a copy of the **Allianz MasterDex 5** "Contract Summary" that shows (page 2) a "Guaranteed Cash Surrender Value" that doesn't equal or exceed the "Initial Premium" until the 7th policy year. It would appear that this result is attained by applying 2% interest to 87.5% of the purchase payment. This policy deserves a closer look as it is marketed very aggressively in my region. I have also attached (to be fair) the "Statement of Understanding" that Allianz apparently asks each customer to sign.

In the Allianz MasterDex 5 annuity, this is what happens:

- You make a payment
- You receive a 5% "premium increase" (a bonus that may be forfeit)
- You receive annual interest (that may or may not be forfeit), either
    - The "floor guarantee" (the Commission's term), or
    - A "minimum guarantee (set by insurer, usually less than money market rates), or
    - The much hyped "participation in the market rate" ("can't lose", you know)
- You withdraw funds (you lose interest and possibly principal under a withdrawal fee schedule that lasts 10 years and is 15% for the first 4 years).
- When you withdraw, a "market value adjustment" can be made that could further increase the amount of fee (or lost interest).

In this MasterDex 5, the best 'guaranteed" scenario for someone that does not withdraw any funds over a 10 year period is to receive an annual return of 0.67% for their purchase payment. (See the chart of values on page 2 of the "contract summary") Of course, Allianz might pay higher interest, and of course that higher interest may be offset or eliminated entirely because of withdrawal fees and market value adjustments.

Honestly now, would any responsible financial analyst conclude that any company taking an investment of $X and making only a guarantee of an annual return of 0.67% over 10 years would be undertaking any investment risk in that transaction? I don't think so.

More importantly, would anyone honestly look at the two documents that I have attached (the Allianz "contract summary" and the "statement of understanding") and think that an "average" investor could both understand and reconcile those documents? I don't think so.

Obviously, there are many different equity index annuity variations in the market, and each may be better or worse than the one I identified in this paper. And, if you made the same calculation for 10 years in the "3% on 90% situation, the average annual return would be 2.10%, less than average money market rates which carry no investment risk.

> **UPDATE NOTE**: I have just received a copy of another EIA policy during discovery in a pending law suit that significantly sets the "guaranteed interest" bar much lower than Allianz. **The National Western (Austin, Texas) "Ultra Classic" annuity guarantees 1% on 87.5% -- which allows the original purchase payment to be guaranteed only during the 14th year.** The withdrawal fees in this EIA last 13 years, and this product was sold to a 75 year old male.

It would seem self-admitted, that the Commission has operated (to date) on the unfounded premise that any insurer whose EIA assets reside in their General Account , and where they make an interest rate guarantee equal to the State's requirement for determining standard non-forfeiture values --- has undertaken a significant investment risk in the policy.

With all due respect, a continuation of the Commission's position cannot in any fair analysis, be justified. Rule 151 should be scrapped and driven to the dustbin of history before thousands more hard working citizens are damaged at the hands of unscrupulous agents and asset-hungry insurers.

All of the above discussion begs the primary issue of whether the insurance company has made a significant interest rate guarantee IN ADVANCE. While the insignificant "floor guarantee" is made in advance – I know of no EIA that provides a guarantee of specific "current" rates (based on its specific index formula) IN ADVANCE. Only the formula (which assures that the insurer will not have to pay more than it has earned in the segregated asset account established for its EIA products) is guaranteed. It is important to keep in mind that it is these current rate expectations that form the basis for the sale.

Marketing

This has been, to date, a toothless benchmark. Every insurer who issues equity index annuities has carefully included in their marketing material several references to the "retirement income" possibilities of the product, or some other "traditional" annuity reference that it can point to in order to deflect criticism that it is marketing the product "primarily as an investment".

Perhaps it has occurred, but I know of no insurer that has been forced to register equity index annuities as securities because of how they were marketed. I know of some that were "slapped on the wrist" and such action caused them (probably) to insert some more self-serving statements in sales literature that no one reads.

The real mischief is made at the level of the "independent agent" engaged by the insurer to sell their EIAs. And, much of this mischief happens on a yellow sheet of paper at the kitchen table of Americans that are 65 - 90 years old. Of course, this yellow sheet is never signed by the agent, seldom is left with the customer, and the customer's memory of it is later (should they complain) shouted down by the agent and insurer as they point to their printed (and confusing) literature.

If what I say is true, the question must be asked, "Why would any reasonably intelligent person ever entrust their hard earned retirement money to someone for a product they do not understand?" Many thousands of people do, and most often the equity index annuity (if you applied security related standards of suitability) would be found to be not suitable for a majority of these customers. I will attempt to explain the dynamics of the "equity index sales scheme" that prompts these decisions later in this paper.

Commissions – At the heart of any practical analysis of equity index annuities, there must be an understanding of the role that commissions play, and their effect on agents, and policy design. Again, I will not attempt to discuss the internal investment strategy of the insurer.

With any annuity product, the insurer must plan for the recapture of their acquisition expenses (commissions, marketing and promotion costs) incurred in putting a policy "on the books". Thereafter, there are relatively small maintenance expenses to cover. Lastly, the insurer must have an "after tax return on invested capital" goal (usually a minimum of 15%) for the "book" of business within that annuity product design.

To successfully "manage" this book of business, it is fundamental for the insurer to predict accurately how long an average policy will stay on the books, so that these expenses can be amortized and the profit goal met. The most common way to "encourage" policy owners to keep their annuities is to penalize them via withdrawal fees (and potential market value adjustments) for cashing in their annuities.

For perspective, the Commission should understand that the "3% on 90%" standard does not in any way indicate that the insurer has 10% deducted for the expenses I mention above. In any given state, an insurer that had 0% acquisition expenses and one that had 20% acquisition expenses would have to meet the same "3% on 90%" non-forfeiture standard.

The amount and length of the withdrawal fee schedule can be predictive of the overall commissions paid by the insurer. The initial year withdrawal fee will be set within a couple of percentage points from the commissions that have been paid. As an example, with a 15% first year withdrawal fee, it is reasonable to assume that its total commissions for that EIA are between 12% and 18%. I doubt that any insurer providing comments to the Commission will (without being requested) give copies of their commission schedules and agent commission agreements.

It should be also noted that there is no regulation that I am aware of that requires an agent to reveal to the customer the amount of commission they receive on a transaction of this sort. **THE CUSTOMER ALWAYS PAYS THE COMMISSIONS: THE HIGHER THE COMMISSION -- THE HIGHER THE FEES AND GREATER RESTRICTIONS ON LIQUIDITY.** If the above statement is true, and it is. Why isn't the customer given information that is truly helpful to their purchase decision? An appropriate industry wide commission disclosure could be easily developed.

It is the insurer's need to recapture its commission expenses that produces the esoteric vesting schedules, the long withdrawal fee period, the market value adjustments, the caps and market averaging formulas, and other restrictions on liquidity. Equity index products do not have to be so complex – and the complexity exists to obscure the product's commission cost.

Suitability – Today, agents and insurers largely feel that (because the EIAs will eventually pay back more than the original purchase payment) that "there is no risk" and that the product is suitable for "everyone", without restrictions. This is, of course, nonsense.

The primary areas of suitability concern in the sale of EIAs are as follows:

Overage Sales

While there is some concern about the sale of a complex product to someone of advanced age because of diminished capacity, the real issue is liquidity. If an EIA with a 12 year withdrawal fee schedule was sold to a 75 year old male, the liquidity restrictions would be longer than his life expectancy (9.6 years). The risks associated with restricted liquidity should be fully disclosed.

Concentration

There are abundant examples of EIAs being sold to 90% - 100% of a retiree's liquid net worth (investable assets). This situation should never occur without the risks associated with investment concentration being fully disclosed. Interestingly, these "large sales" often exceed the state limits for protection under their "Guarantee Association" programs that generally cap coverage at $100,000 for individual annuities. With respect to registered (FINRA) firms, there are directives (Notice to Members 99-35 for example) that address annuity concentration and direct members to establish standards with regard to "large sales" and concentration. As a result, many registered firms have set annuity concentration levels to about 30-40% of liquid net assets. Transactions that exceed the standard require review by a Principal.

Tax-Qualified Assets

LIMRA (Life Insurance Marketing Research Association), an organization established and funded by the insurance industry, periodically conducts surveys of customers regarding the reasons they buy annuities. Always, the number one response from these annuity owners is the annuity advantage of "tax-deferral" (over all other investments where the investment gain or return is taxed each year). This "annuity advantage" does not exist where the assets used to purchase the annuity come from certain "tax-qualified plans" (IRAs, 401-k, etc) because such plans are already entitled to defer taxes on investment gains. There are literally hundreds of unbiased financial reporters and commentators that have written to this subject and take the position that it is fundamentally not suitable to recommend higher cost annuities over lower cost equivalent products – where the justification for the higher annuity costs (tax deferral) does not exist.

Illusory "Bonuses"

There are many EIAs that use "bonuses" (often under other names such as "supplemental credits", "additional premium", and various other monikers) as a "come on" to grease the skids and overcome objections to the purchase of the EIA. The agent uses the "bonus" (often 10% or greater) sometimes to support the replacement of other annuities – and to disregard the withdrawal fees that are incurred to do so. **THESE BONUSES DO NOT HAVE ANY INHERENT VALUE TO THE CUSTOMER AND THERE SHOULD BE A RESPONSIBILITY RUNNING TO THE AGENT AND INSURER TO MAKE EXTRAORDINARY DISCLOSURES.** The above allegation can be proven by comparing the "bonus product" from an insurer to the "non-bonus product" of that same company. Without exception, the bonus product will have higher fees and/or greater restrictions on liquidity than the non-bonus product. When measured, the financial difference will be adequate to repay the insurer for this supposed bonus.

Fictitious "Groups"

There is a practice adopted by some insurance companies to issue "Certificates of Participation" under group EIAs to customers rather that "individual contracts". The only problem is that the customer usually has no affinity of interest with other members of this "fake group". Under most state insurance laws, bona fide groups are typically "*common employer*", union members, and members of some defined "discretionary group" (think AARP) that is formed for purposes other than to buy insurance. These insurance companies have noticed that group annuities enjoy favorable treatment in the nature of reserve calculations, premium tax liability, policy review exemptions, and other benefits not available to individual contracts. The insurance company solution – is often to form an internal trust and issue the group annuity contract **to itself** without regard for the intent of the group insurance laws. This amounts to "self dealing" that denies to the customer the normal and expected protections that are present in a bona fide group, including the group owner doing due diligence on the insurer and being an independent and genuine conduit for complaints and service.

Replacements

In the many cases I have reviewed, the agent usually sells multiple annuities over time to the same customer. Often the transaction involves the replacement of one annuity for another (sometimes the first annuity is owned for only a short period of time, thereby causing large withdrawal fees). The agent is commissioned on each sale. In the securities industry, such replacements (without a legitimate and understandable purpose benefiting the customer) would amount to "churning". The EIA, because of its complexity, the use of "bonuses", and the promise of "participating in the market" is particularly attractive to agents for replacement. State insurance laws provide no reliable protection for consumers, and ironically provide a shield to agents for misguided replacements. The Commission should make itself aware of the studies of Professor Moshe Milevsky (York University, Toronto) as he has written a series of papers on various annuity issues. One of these, "Exchanging Variable Annuities: An Optional Test For Suitability", is particularly appropriate and the principles are generally applicable to EIAs as well as variable annuities. The conclusion is inescapable that most annuity replacements are not in the best interests of the customer. State insurance regulations involving replacements are totally inadequate to protect the public.

"Investment Planning" Fraud

The insurance agents selling EIAs are almost never registered (State or Federal) as Investment Advisors. Many agents charge separate fees (following the "free lunch"

seminar) to meet with the customer and engage "investment planning", or "investment education". Regardless of the terminology used, the customer is of the mind that an evaluation is taking place that includes consideration of their investment goals, available assets, risk tolerance, and income needs – compared to a universe of available products -- and that the agent will recommend only those products that are consistent with their individual "profile". In fact, this matching exercise of aligning customers with suitable products almost never occurs. It is also true that the agent often recommends the sale of securities already owned by the prospect so that funds to acquire an EIA can be obtained.

Predatory Sales Techniques

Amazingly, there are some annuity sales operations that utilize all of the sales practices below on a regular basis:

- Target senior demographics for concentrated marketing and high-pressure promotion.
- Invitations to "something for nothing" free lunch/dinner seminars.
- Use senior "subjects" (living trusts, Medicare, social security) as a "come on" to attract attendance.
- Flaunt exaggerated titles (often "senior"related") and dubious unrelated experience (ghost written articles and books, for example) to gain trust of seminar attendees.
- Use of fear tactics to suggest the potential failure of traditional institutions like banks, mutual funds, and even the U.S. Government.
- Focus on annuity "bells and whistles" (bonuses, complicated "living benefits, nursing home benefits, etc) rather than the annuity itself.
- Directing attention to immediate (but sometimes illusory) benefits, and not the long term nature of the annuity product.
- Permitting only limited time and attention of the customer to review inadequate and complex disclosure documents.
- Using religious, or Masonic lodge connections to gain trust and to deflect questions or objections concerning the product.
- "Baiting and switching", in that high-commission EIAs are substituted for introductory products or services.

- "Steering" customers suitable for lower cost products, to the highest commission (and therefore highest cost) EIAs.

- Use of misleading, but attractive, third party endorsements.

Suggestions — The present situation is untenable. If continued, the Commission would be abdicating its Congressional mandated responsibilities, in my opinion. If the Commission is inclined to provide the protections of Federal securities laws to our citizens with regard to EIA products, it can easily do so.

I predict that the biggest two objections the industry will have to registration of EIA products are:

1. That already issued, and potentially non-conforming EIA products make insurance companies subject to potential liability after they had relied in "good faith" on the terms of existing Rule 151. Good faith can be examined in a number of ways. Some examples: (a) Did the company request and receive "no action" letters from the SEC, (b) did the company rely on the opinions of outside counsel prior to issuing the EIA products, (c) did the company employ "evasive" techniques (i.e. using "fake group" contracts) to avoid state insurance department scrutiny, (d) did the company introduce new, and possibly non-qualifying EIA features after the promulgation of Rule 151, and (e) did the company require standard suitability procedures of its "independent" insurance agents? This is not an insoluble problem, and the Commission has plenty of smart attorneys. Figure out a potential resolution to this issue before going public with your conclusions.

2. Requiring FINRA registration of insurance agents to sell EIA products will disrupt a distribution channel that has taken years to develop. The Commission has no obligation to continue or extend a situation that imperils customers (by exposing those customers to undisclosed risks) in the marketplace. Either agents should get registered to sell securities, or they shouldn't sell them. It should be that simple.

If the Commission decides to reform Rule 151 rather than require the registration of all EIA products, it has a somewhat harder task in the days ahead. In this scenario, I imagine that some or all of the safe harbor elements might be changed or supplemented. Listed below are some ideas of how this might be done to reduce the likelihood of inappropriate sales of complicated financial products with undisclosed risks.

- Require a standard basic "suitability" standard of the insurance company in order to police the sales practices of its independent agents. This standard could

- prohibit "undue EIA concentration", provide a 48 hour "cooling off" period for review of disclosure documents, provide disclosure of "total commissions" paid on the EIA transaction, prohibit replacements of EIA where significant withdrawal fees are incurred (without insurer certification that transaction has been reviewed by company representative and found "suitable").

- Require standard disclosure language to reveal the lack of value in "bonus" benefits, and first year teaser rates – in that higher fees and charges are levied to recoup the bonus or teaser rate interest.

- Prohibit the use of group EIA policies without the existence of a bona fide "group" whereby members have an affinity with each other for purposes other than to buy annuities or insurance.

- Prohibit the payment of EIA commission to anyone that does not participate in the actual sales process, provides a customer referral, or does not provide direct daily supervisory responsibilities over the selling agent.

- Change the minimum EIA standards that must be met for the insurance company to have "accepted the investment risk" in the policy. For example:

    - Require the "minimum cash surrender value" to be at least equal to the purchase payment used to buy the EIA by the end of the 2nd policy year.

    - Limit the length of the withdrawal fee schedule to 10 years (but in no event longer than the life expectancy of the customer).

    - Prohibit the use of "market value adjustment" contract provisions in EIAs from being used in combination with equity index formulas to reduce interest already credited.

    - Create a universal "vesting standard" whereby index formula interest credits cannot be forfeit after the EIA has been in force a certain number of years.

    - Require interest to be guaranteed "in advance", not simply to have the overly complicated index formula (negatively compounded by the application of a market value adjustment) guaranteed.

Thank you for the opportunity to provide the Commission with this analysis. Please feel free to call (817) 573-6740, or e-mail to maxfordco@aol.com if you have any questions or require further information.

David M. Sanderford, J.D.

August 2, 2008

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-6009

Re: File NO. S7 – 22- 97

Sir:

This letter provides a response (in triplicate, attached hereto) to the Commission's request (Release No. 33 – 7438) for public "…comments on the structure of equity index insurance products, the manner in which they are marketed, and any other matters the Commission should consider in addressing federal securities law issues raised by equity index insurance products."

These comments are provided by me as a private citizen who has observed the entire history and development of the above referenced products from two different perspectives: first, as an "industry insider" with senior management positions in legal, compliance, and marketing areas for insurers and their distributors, and secondly, as an expert witness in securities and financial litigation. In my consulting practice I have been retained by the New York Stock Exchange to provide evaluation and testimony regarding "annuity sales abuses" in contested enforcement actions against registered representatives.

I believe this is an important effort the Commission is undertaking and would be pleased to make myself available for questions and/or testimony on subjects related to equity index insurance products.

Sincerely,

David M. Sanderford
President/CEO

Attachments

ALLIANZ LIFE INSURANCE COMPANY OF NORTH AMERICA
CONTRACT SUMMARY

Agent:

Policy Number:
Prepared For:

Age: 71
Sex: MALE
Birthdate:
Policy Date:
Plan Name: MasterDex 5 Annuity (A Flexible Premium Deferred Annuity Policy with an Index Benefit)

Initial Premium

Based on an Initial Premium of , the values on the following page show the Current and Guaranteed Accumulation Values and the Current and Guaranteed Cash Surrender Values prior to receiving annuity payments.

The Initial Premium and any Additional Premium paid during the first five Policy Years receive a 5.00% Premium Increase - which is credited on the same day Premium is received.

The Supplemental Application will have been completed to indicate the Premium Allocation Percentages to the Index Allocations and/or Interest Allocation.

Adjustments for each Index Allocation, if any, are added to the Accumulation Value at the end of each Policy Year. The Annual Index Rate determines the Adjustment for each Index Allocation. The Annual Index Rate is the sum of the Monthly Index Rates for the Policy Year or zero, whichever is greater. The Participation Rate determines the maximum percentage of the Unadjusted Index Change used to calculate the Monthly Index Rate for each Index Allocation. The Monthly Cap determines the maximum Monthly Index Rate. Annuitization or a full surrender of the policy prior to the completion of a Policy Year will result in no Index Adjustment for that Policy Year.

Adjustments for the Interest Allocation are added to the Accumulation Value. The allocated amount will earn interest at the current declared rate of interest and will be credited monthly. The guaranteed minimum rate of interest credited is 2.00% for the first Policy Year and 1.5% thereafter, compounded annually.

Any Additional Premium paid plus any applicable Premium Increase will be placed in the Interim Interest Account until the start of the next Policy Year. The current declared rate of interest will be calculated and credited monthly and the guaranteed minimum rate of interest credited is 2.00% for the first Policy Year and 1.5% thereafter, compounded annually. At the end of the Policy Year, the Interim Interest Account will be allocated to each Allocation according to your Premium Allocation Percentages. The Interim Interest Account will then be set equal to zero.

At any time, you may submit a request to change your Premium Allocation Percentages. When the Interim Interest Account is allocated at the end of a Policy Year, you have the option to change that allocation by sending us Notice within 21 days. If Notice is received after 21 days, it will not be effective until the next allocation.

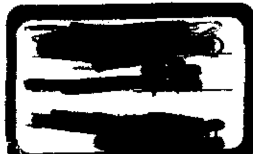
At any time, you may submit a request to change your Reallocation Percentages and/or reallocate your Accumulation Value. Reallocation will only occur at the beginning of a Policy Year and is not automatic. To be effective for the current Policy Year, you must send us Notice within 21 days following the beginning of the Policy Year. If Notice is received after 21 days, it will not be effective until the beginning of the next Policy Year.

The Accumulation Value, at issue, is equal to the Initial Premium plus any applicable Premium Increase. It is increased by any Interim Interest Account additions, any Adjustments, and any Partial Adjustments. It is decreased by any Partial Surrenders and any Systematic Withdrawal of Credit payments.

The Accumulation Value is the value to which any applicable surrender charge and Market Value Adjustment is applied upon Full Surrender. There is no surrender charge after the 10th Policy Year. There is no Market Value Adjustment in the first 12 Policy Months or after the 10th Policy Year.

A Partial or Full Surrender of the policy will result in a Market Value Adjustment to the policy value. A Market Value Adjustment may increase or decrease policy values depending on market conditions. If interest rates rise, your Cash Surrender Value will be lower. If interest rates fall, your Cash Surrender Value will be higher. Limits on the Market Value Adjustment are described further in your contract.

The Cash Surrender Value will be the greater of the Guaranteed Minimum Value or the result of the Accumulation Value minus the Full Surrender Charge multiplied by the Market Value Adjustment.



Allianz Life Insurance Company
of North America

PO Box 59060
Minneapolis, MN 55459-0060

800/950-7372

MasterDex 5™ Annuity
Statement of Understanding

Thank you for considering the MasterDex 5 Annuity from Allianz Life® We want to be sure you are aware of all of the benefits and features offered by your policy.

Please read the following summary. If you need additional clarification on any of the items listed below, please refer to the MasterDex 5 Annuity contract.

Once you have read this summary, please sign the last page to confirm you understand the policy you are considering.

How does the MasterDex 5 Annuity work?

The MasterDex 5 Annuity is an equity-indexed product. That means the value of your annuity is linked to one or more nationally recognized indexes that track the ups and downs of the stock market.

If you don't want your policy values to be linked to changes in the stock market, the MasterDex 5 Annuity also allows you to allocate, or designate, some (or all) of your annuity's value to a fixed interest option. This fixed interest option credits your policy with predictable interest, based on established rates that are independent of the equity markets. Your initial interest rate is only guaranteed for the first policy year. After that, your interest is calculated and credited monthly at an annual rate of no less than 1.5% in all policy years.

Please note that although an external index or indexes may affect your policy values, the policy does not directly participate in any stock or equity investments. You are not buying shares of any stock or index. The market indexes do not reflect the dividends paid on the stocks underlying the market indexes.

How do I choose – and change – the way my annuity's value is allocated?

You can choose between the S&P 500 and Nasdaq-100® indexes, or you can decide to earn fixed interest. You can allocate all of your money to any one of these three alternatives, or allocate your money (in 25% increments) to any combination of these three options.

Shortly after each policy anniversary you will receive an annual policy statement. It will include a form that allows you to change your current allocations. If that is your intention, you must complete the allocation change form and return it to the Home Office within 21 days of your policy anniversary. This will lock in your request and determine how your policy values are allocated over the next policy year.

Assuming I allocate my money to one index or both, how can my annuity's value grow?

The MasterDex 5 Annuity uses a monthly point-to-point method to calculate the performance of the S&P 500 and Nasdaq-100. This method tracks the positive and negative changes in the index(es) you have chosen in individual monthly increments. At the end of each policy year, the crediting method adds the 12 monthly subtotals; and then credits any increases to your policy's value.

Please note that although positive monthly increases are limited by an established maximum (or monthly cap), monthly decreases are not limited.

How is the monthly cap determined?

The monthly cap is set at the beginning of each policy year, and then guaranteed not to change during that policy year. The monthly cap will never be less than 1%.

Can you show me how all of this works?

This chart shows monthly positive and negative changes in a hypothetical index, how they are affected by the monthly cap, and how they add up to the annual index rate.

Month	1	2	3	4	5	6	7	8	9	10	11	12
Index growth (%)	5.0	-5.0	2.0	-1.0	2.0	2.0	4.0	-2.0	0.0	-2.0	5.0	0.0
Monthly cap (%)	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Monthly index rate (%)	+2.3	-5.0	+2.0	-1.0	+2.0	+2.0	+2.3	+2.0	+0.0	-2.0	+2.3	+0.0

At the end of the policy year, the 12 individual monthly index rates are added up to determine that year's annual index rate:
+2.3 + (-5.0) + 2.0 + (-1.0) + 2.0 + 2.0 + 2.3 + 2.0 + 0.0 + (-2.0) + 2.3 + 0.0 = 6.9%

Can my annuity's value go down due to losses in the index(es) I choose?

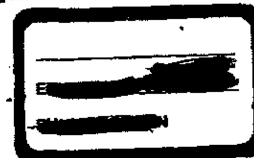
No. If the index(es) suffer a loss in any given year, your principal (the money you put into the annuity) and the 5% premium increase are protected. Any index gains or interest that have been locked in previously are also safe.

Will my annuity's value be based on anything besides the monthly market index gains and losses mentioned earlier?

Yes. Your annuity's value will be affected by the policy's participation rate and when you decide to take money out of the policy.

What is a participation rate?

The participation rate is the percentage of monthly index gains that will be used to determine your policy's annual index rate. The participation rate is 100%, and is guaranteed for the life of the contract. Keep in mind the amount of any monthly gains allowed by your policy's participation rate will still be subject to a cap, or maximum.



Besides this, what other factors impact the value of my *annuity policy?*

The first thing you should know is that, throughout the life of your annuity contract, your MasterDex 5™ Annuity will actually have two separate values. Which one you receive will depend on when – and how – you take money out of the annuity. Those values are the policy's:

- Accumulation value
- Cash surrender value

Accumulation value. The accumulation value equals the premium you pay into the contract, a 5% premium increase, plus any annual indexed increases and/or interest earned. Withdrawals will decrease your policy's accumulation value. This will usually be your policy's highest value.

Cash surrender value. The cash surrender value is your accumulation value *minus a 10-year decreasing surrender charge, plus or minus* a market value adjustment. We discuss surrender charges and the market value adjustment below.

In addition to these values, we are required by law to provide a guaranteed minimum value with all fixed annuities, even though you would receive it ONLY IF the guaranteed minimum value is higher than your policy's cash surrender value described above. The guaranteed minimum value will generally be your lowest policy value. The guaranteed minimum value equals 80% of your first-year premium, plus 87.5% of the premium you submitted after your first policy year – minus any withdrawals – *growing at an annual interest rate* of 3%.

How do I avoid penalties and get my policy's full accumulation value?

One way to receive your policy's accumulation value is to wait until at least your 10th policy anniversary (at which point the surrender charge expires), then take your policy's accumulation value as a lump-sum payment.

You can also let your money accumulate for a minimum of five policy years, then take five years of interest-only payments or *equal payments* of both principal and interest over a 10-year period (or longer). **This is what is meant by "annuitization."**

If you decide not to let your money accumulate for 10 full years, or if you choose a payment option different from the options shown immediately above, you will receive your policy's cash surrender value rather than its accumulation value.

What happens if I cancel my policy?

That depends on when you cancel it. You can fully surrender (cancel) your policy on or after its 10th policy anniversary and get your full accumulation value (as outlined above). If you fully surrender your annuity policy before its 10th anniversary, the amount you receive will be subject to a surrender charge and market value adjustment (MVA).

What is a surrender charge?

The surrender charge is the penalty you pay to surrender (cancel) your policy. The surrender charge on your MasterDex 5 Annuity will also apply to partial surrenders, which are withdrawals that do not meet our free withdrawal requirements (which are explained later).

The surrender charge starts at 15%, then gradually decreases by .1786% on each monthly anniversary beginning in policy year four, until it finally reaches zero (on your 10th policy anniversary).

Here's a chart that shows the approximate amount we will deduct from your accumulation value if you cancel your policy in any given policy year. It also shows how the surrender charge diminishes as time passes.

Start of policy year	1	2	3	4	5	6	7	8	9	10	11
Surrender charge	15.00%	15.00%	15.00%	15.00%	12.86%	10.71%	8.57%	6.43%	4.29%	2.14%	0.00%

Note: The above chart shows annual decreases in the surrender charge. Actually, it decreases monthly (at a rate of .1786% per month), beginning in policy year four until day one of policy year 11.

I'm not familiar with the term "market value adjustment." What is it?

The market value adjustment, or MVA, is a factor that acts to counterbalance the overall change in interest rates while you've owned your MasterDex 5 Annuity. So if you decide to fully or partially surrender your policy, the market value adjustment can either increase or decrease the cash surrender value you receive. Please refer to your policy for additional details on the MVA.

For now, you should understand that the MVA is inversely proportional to the change in interest rates between the time you purchase your policy and when you surrender it.

- In general, if interest rates have increased since you purchased your policy, the effect of the MVA will likely lower your policy's cash surrender value. As such, you bear some risk associated with increases in interest rates.
- If rates have gone down since you purchased your policy, you will likely have a higher cash surrender value due to the effect of the MVA.

Can you show me how the surrender charge and market value adjustment would affect a sample MasterDex 5 Annuity?

A complete chart showing hypothetical values for the MasterDex 5 Annuity is presented at the end of this document. Please look it over.

Can I take money out of my annuity without incurring a penalty?

It's quite possible you will want money from your annuity policy somewhere down the road. But you may not need it all. We have a variety of ways you can get money out of your annuity policy without penalties or charges, including:

- Free withdrawals
- Systematic Withdrawal of Credits
- Policy loans
- Required minimum distributions
- Our Nursing Home Benefit

How can I take a free withdrawal from my policy?

Our free withdrawal option lets you access a portion of your policy's value without incurring a penalty. You can withdraw up to 10% of your premium each year, until you have withdrawn a maximum of 50% of the premium you've paid into the policy. These withdrawals will avoid surrender charges provided that:

- No more than one withdrawal is taken within a 12-month period.
- You don't add any additional premium to the policy within 12 months of taking a free withdrawal.
- You don't request a full (or partial) surrender or begin annuitization payments within 12 months of taking a free withdrawal.

What is Systematic Withdrawal of Credits?

Since your MasterDex 5℠ Annuity is an equity-indexed product, you have the potential to earn credits based on the performance of the index(es) you select. After the fifth policy year you can select to have these annual index credits paid to you as they are earned. We call this Systematic Withdrawal of Credits. You can take advantage of this benefit as long as you have not begun the scheduled payment program we defined earlier as "annuitization."

What if I need to take a policy loan?

Loans are available on nonqualified annuities and some tax-qualified annuities (TSAs). You can borrow up to 50% of your policy's cash surrender value (up to a $50,000 maximum). Like any loan, policy loans are subject to an annual interest charge, but they are penalty-free as long as they are repaid with interest. Please note: Loans on nonqualified annuities may be taxable at distribution.

I understand I may have to take minimum distributions some day. Does my annuity allow these?

Based on your age (usually 70½ or older) and the tax designation of your policy (IRA, SEP, etc.) you may have to take minimum distribution payments. If they are taken annually in December or monthly throughout the year, required minimum distributions (RMDs) are penalty-free, although they will reduce the amount available for free withdrawals. You may not exceed the annual RMD amount specified by the IRS, which will be based on your age and the value of your policy. Allianz Life® will only send a required minimum distribution for the policies you have with us.

How can your Nursing Home Benefit help me access my money without penalty?

After the first policy anniversary, if you are the policyowner and become confined to a nursing home for 30 out of 35 consecutive days, your full accumulation value can be paid to you over as little as five years of annuitization payments.

What types of withdrawals are subject to penalty – and what are the penalties?

We've just outlined five ways to receive a portion of your premium with no surrender charge or market value adjustment. You will incur both if you take a partial surrender from your policy any other way. All three of the policy values we described above will be diminished by the amount of your partial surrender and penalties assessed.

Are there any tax consequences if I withdraw money?

Regardless of whether the distribution is penalty-free or subject to a penalty, there may be tax consequences if you pull money out of your annuity. In addition, any distribution you receive from an annuity prior to age 59½ may be subject to a 10% IRS penalty. Allianz Life does not provide legal counsel or tax advice, so please consult a financial advisor.

Can I *add* money to my MasterDex 5 Annuity down the road?

Yes. Additional money (or premium) may be added to your annuity at any time within the first five policy years. The additional premium you pay during a policy year will automatically be credited with an immediate 5% increase and then placed in an interim interest account where it will earn interest until the start of the next policy year. This premium and increase will then be distributed according to your premium allocation choices.

What happens if I die before I have received all of my annuity's value?

Your beneficiary(ies) may choose to receive annuitization payments over the course of five years (or longer). If so, they will receive your policy's accumulation value.

They may, on the other hand, want a lump-sum payment. If this is their choice they will receive the policy's cash surrender value or the amount of premium paid minus withdrawals, whichever is greater.

Are there any other important points I should know about annuities like the MasterDex 5 Annuity?

If you are purchasing our MasterDex 5 Annuity to replace an annuity you currently own, compare the two products carefully. Keep in mind *that you may incur a surrender charge* when you cancel your existing annuity to purchase your MasterDex 5.

If you are purchasing the MasterDex 5 Annuity as part of a qualified plan such as an Individual Retirement Account (IRA), your decision should be based on benefits other than tax-deferred growth, as the Internal Revenue Service already grants tax-deferred status to plans like IRAs.

Can I see all the various values and factors that impact the value of my MasterDex 5® Annuity?

The chart below shows hypothetical values for a MasterDex 5 Annuity that was purchased with an initial premium of $100,000. You can track the $100,000 initial premium – and the 5% increase – as they are impacted by hypothetical changes in the monthly index.

Notice the relationship between the accumulation value and cash surrender value. You can see that once the policy has completed its 10-year accumulation period, its accumulation value and cash surrender value are identical. The guaranteed minimum value is also listed for your reference.

End of policy year	Sum of monthly index rates	Annual index rate (cannot be negative)	Annual index adjustment (cannot be negative)	Accumulation value	Surrender charge	Change in 10-year Treasury Rate[2] from Issue	MVA[3] (market value adjustment)	Cash surrender value	Guaranteed minimum value
Issue				$105,000[1]	15.00%			=> $89,250	$80,000
1	-8%	0%	+ $0	=> $105,000	15.00%	0.0%	x 1.000	=> $89,250	$82,400
2	16%	16%	+ $16,800	=> $121,800	15.00%	1.4%[4]	x 0.899	=> $93,074	$84,872
3	12%	12%	+ $14,616	=> $136,416	15.00%	1.7%	x 0.893	=> $103,568	$87,418
4	4%	4%	+ $5,457	=> $141,873	12.86%	0.7%	x 0.961	=> $118,773	$90,041
5	-12%	0%	+ $0	=> $141,873	10.71%	1.2%	x 0.945	=> $119,649	$92,742
6	11%	11%	+ $15,606	=> $157,479	8.57%	-0.1%	x 1.004	=> $144,535	$95,524
7	12%	12%	+ $18,897	=> $176,376	6.43%	-0.6%[5]	x 1.017	=> $167,911	$98,390
8	4%	4%	+ $7,055	=> $183,431	4.29%	-1.0%	x 1.019	=> $178,971	$101,342
9	-10%	0%	+ $0	=> $183,431	2.14%	-0.5%	x 1.005	=> $180,369	$104,382
10	13%	13%	+ $23,846	=> $207,277	0.00%		x 1.000	=> $207,277	$107,513

[1] At issue, accumulation value equals $100,000 initial premium plus immediate 5% increase ($5,000)

[2] Assumes 10-year Treasury Rate at issue is 4.5%

[3] This chart shows hypothetical market value adjustments (and surrender charges) based upon your fully surrendering your MasterDex 5 Annuity policy on the last day of the policy year shown. Actual market value adjustments are calculated according to a formula that is presented in your policy.

[4] This example assumes an increase in the 10-year constant maturity rate from 4.5% to 5.9% (a 1.4% increase) and the corresponding effect on the MVA. As you can see, an increase in this rate leads to an MVA that is less than 1. An MVA that is less than 1 decreases the policy's cash surrender value.

[5] This example assumes a decrease in the 10-year constant maturity rate from 4.5% to 3.9% (a .6% decrease) and the corresponding effect on the MVA. As you can see, a decrease in this rate leads to an MVA that is greater than 1. An MVA that is greater than 1 increases the policy's cash surrender value.

I have read the information above. It has been explained to me by the agent and I believe the MasterDex 5 Annuity is suitable for my financial goals. I understand that amounts payable under this policy are subject to a market value adjustment that can cause the amount to be higher or lower. I have also received and read the MasterDex 5 Annuity consumer brochure. I understand that any values shown, other than guaranteed minimum values, are not guarantees, promises, or warranties. I understand that I may return my policy within the free look period (shown on the first page of my policy) if I am dissatisfied for any reason.

Owner Date

I have presented and provided a signed copy of this disclosure to the owner. I have not made statements that differ from the disclosure form and no promises or assurances have been made about the future values of the policy.

Agent Date

"Standard & Poor's®," "S&P®," "S&P 500®," "Standard & Poor's 500," and "500" are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by Allianz Life Insurance Company of North America. The product is not sponsored, endorsed, sold or promoted by Standard & Poor's and Standard & Poor's makes no representation regarding the advisability of purchasing the product.

The Nasdaq-100®, Nasdaq-100 Index®, and Nasdaq® are trade or service marks of The Nasdaq Stock Market, Inc. (which with its affiliates are the Corporations) and are licensed for use by Allianz Life Insurance Company of North America. The product(s) have not been passed on by the Corporations as to their legality or suitability. The product(s) are not issued, endorsed, sold, or promoted by the Corporations. THE CORPORATIONS MAKE NO WARRANTIES AND BEAR NO LIABILITY WITH RESPECT TO THE PRODUCT(S).