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September 8, 2008

Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release Number S7-14-08   Proposed SEC Rule 151A

In response to your *"request* [for] *comment on the scope of the proposed definition* [of] ***Indexed Annuities and Certain Other Insurance Contracts,*"** it is important to keep in mind that my comments pertain to "Fixed Index Annuities." Throughout the Release you use the term "indexed annuities" in making the case for federal regulatory control. In omitting the word "fixed" as opposed to "variable," one wonders if you are in fact referring to Fixed Index Annuities since the term "indexed annuities" is consistently used in the context of "investment risk" in which the purchaser is exposed to the risk of loss due to market fluctuations.

The Release, offering justification for the Proposed Rule, as it appears in the Federal Register, presents a number of conclusions which blatantly contradict the facts surrounding Fixed Index Annuities. It will be shown here that the basic premise upon which the argument is developed is seriously flawed, that the Proposed Rule would set a dangerous precedent in the area of bureaucratic overreach, do damage to the reputation of SEC, and result in an excessive burden on insurers, agents and consumers alike.

In the **Executive Summary**, it states: *"Insurance provides protection against risk, and the courts have held that the allocation of investment risk is a significant factor in distinguishing a security from a contract of insurance. ...the allocation of investment risk is significant in determining whether a particular contract that is regulated as insurance under state law is insurance for purposes of the federal securities laws."* The key word in this passage is *"allocation"* since it refers to the distribution of investment risk between insurer and purchaser. There is no such "allocation of investment risk" with Fixed Index Annuities.

That statement is followed by: *"Individuals who purchase indexed annuities are exposed to a significant investment risk – i.e., the volatility of the underlying securities index."* The only way one can buy into that statement is to change the meaning of two words: "investment" and "risk."

"Investment" within this context, by definition, is "the choice by the individual to risk his savings with the hope of gain." It is in the risk-return spectrum – the relationship between the amount of return gained on an investment and the amount of risk undertaken in that investment. The more return sought, the more risk that must be undertaken. The term "investment risk" has been used profusely to support the arguments in this Release. We shall see that Fixed Index Annuities do not qualify as an investment nor is there any risk involved.

"Risk" by definition is "the chance of injury, damage or loss; dangerous chance; hazard."

The Release goes into great detail concerning "investment risk," calling on Court decisions and provisions of the Securities Act to make the case that indexed annuities should be reclassified and treated as securities investments requiring federal regulatory control.

First, the distinguishing mark of securities is RISK (as defined above), which motivates investors' need to diversify, which still does not protect against loss, it merely reduces the risk. By contrast, the distinguishing mark of Fixed Index Annuities is SAFETY, with guarantees against market loss. There is no investment in capital markets here. The potential for gains greater than traditional savings vehicles is accomplished by "linking" annuity fund growth to the performance of one or more external market indexes. The annuity owner is not investing "in" the market and is therefore not exposed to market risk. Growth is based on a "formula" rather than an investment. Thus, Fixed Index Annuities are savings vehicles, not investments and should not be placed in the arena of securities.

Great care must be taken in analyzing the rationale used by the Commission in arriving at the conclusions stated. Example: On page 37752 we find: *"When the amounts payable by an insurer under an indexed annuity are more likely than not to exceed the amounts guaranteed under the contract, the majority of the investment risk for the fluctuating, equity-linked portion of the return is borne by the individual purchaser, not the insurer. The individual underwrites the effect of the underlying index's performance on his or her contract investment and assumes the majority of the investment risk for the equity-linked returns under the contract."*

There are a number of flaws in that paragraph:

First, *"...the amounts guaranteed under the contract..."* One such guarantee is contingent upon meeting the deferral conditions by avoiding an early surrender of the contract. In such case, the guarantee would include 100% of principal plus bonus (if applicable) plus interest and/or indexed additions. This is referred to as the Full Annuitization Value. *"When the amounts payable...are more likely than not to exceed the amounts guaranteed under the contract..."* Since the guaranteed amounts payable include principal, bonus and additions, what else could exceed those amounts? The sentence makes no sense – unless the "amounts guaranteed under the contract" refer to the "minimum" guarantee in the event of early surrender, an amount less than the principal. If the Commission is using that amount as a base line relative to indexing, the entire premise is flawed.

In order to understand the basic functions of a Fixed Index Annuity, one must first assume NO early surrender and work from that base line. The proposition to the buyer is that he has an opportunity through various indexing methods for gains in excess of ordinary savings vehicles, but in no case will he experience a loss due to market risk. What the Commission is saying in the above statement is that the purchaser is *"...exposed to significant investment risk..."* should those gains not materialize or be less than anticipated due to index volatility. That, of course, is sheer nonsense. Where is the "risk" here? There is none. Since when is loss of anticipated gain a risk of one's principal? Again, investment risk is a "hazard, the chance of injury, damage or loss." One can only conclude that the writer has in mind the "minimum guarantee" since the surrender charge seems to be a major issue in other portions of his argument. But the surrender charge kicks in only in the event of an early withdrawal and is not germane to the rationale presented here. So let's talk about the surrender charge:

An early surrender and the surrender charge should not be considered in the context of index crediting but must be viewed separately if one is to do justice to the argument. An early surrender of the contract is a violation by the annuity owner of the conditions under which the no-loss guarantee is predicated. That applies to any guarantee or warranty in a free market environment. To put that under the umbrella of investment risk is to do damage to the English language and misrepresent the conditions of the contract. Any attempt to protect the consumer

from such possible loss is to relieve him of the responsibility to use the product according to product design. There is too much of that already in our society. The car buyer is exposed to the risk of repair costs only if he violates the conditions of the warranty.

Second, this explanation renders the remainder of the above quote ineffective and contradictory.

On the same page it says, *"The federal interest in providing investors with disclosure, antifraud, and sales practice protections arises when individuals are offered indexed annuities that expose them to securities investment risk."* The writer is obviously not referring here to variable annuities since he follows this statement with, *"Individuals who purchase such indexed annuities assume many of the same risks and rewards that investors assume when investing their money in mutual funds, variable annuities, and other securities."* If we are still talking about Fixed Index Annuities, that statement is blatantly false!

He then makes the claim that *"...a fundamental difference between these securities and indexed annuities is that – with few exceptions – indexed annuities historically have not been registered as securities."* Why? Simply because the fundamental difference is that Fixed Index Annuities are not securities and have no business being registered as such.

A typical consumer brochure states specifically that ***"When you buy a fixed index annuity you own an insurance contract – you are not buying shares of any stock or index."*** All products are identified by their basic structure and utility. Calling a product what it is not doesn't make it so. Having previously – and erroneously – been referred to as "equity index annuities" does not change the fact that they are (now properly called) Fixed Index Annuities. The word "equity" was dropped because it carries the connotation of risk since the very word pertains to assets which could be lost in capital markets. Thus, "Fixed Index Annuities" accurately identifies the products as something other than securities investments.

He goes on – *"As a result, most purchasers of indexed annuities have not received the benefits of federally mandated disclosure and sales practice protections."* The statement assumes that the States are incapable or properly regulating these products, a dangerous position to take and one that speaks of more bureaucratic overreach. The insurance industry has been and continues to be very aggressive in this area. Strict guidelines have been published and agent training enforced. If an agent misrepresents the product – either by commission or omission – his contract with the company is sufficient to deal with his behavior, up to and including dismissal.

This, then, is a question of BEHAVIOR. SEC should not attempt to deal with wrong behavior by reclassifying the product with the claim that the existing authority is not up to the task, thus extending their reach into an area beyond their jurisdiction. We do not change the rules of a game simply because someone violates the rules. If the rules are valid, let them stand, and deal with the violator. The rules are valid and adequate at the State level. Let them stand.

SEC's action here is not just a matter of reclassifying a product –it speaks of a deeper, more serious problem. The Federal Government is notorious for assuming authority it does not constitutionally possess. We should all – at every level – be guided by Amendment X to the U.S. Constitution: **"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."** Regulatory control of Fixed Index Annuities rightfully belong to the States, not the Federal Government. We should all keep in mind and be motivated by the fact that this government "of" and "by" the people is also "for" the people.

The Release further speaks of *"indexed annuities"* in the context of *"investor protection"* under *"federal securities laws."* Again, the Fixed Index Annuity owner is not investing in securities, therefore is in no need of "investor protection." The protections provided by State and insurer regulations plus extensive and comprehensive marketing materials and agent training in the areas of Suitability and Disclosure are sufficient to provide the protections to which the purchaser is entitled. There is the State Buyer's Guide, company Product Brochure, Preliminary Contract Disclosure, Statement of Understanding, and the Application itself. The Product Suitability Form is a comprehensive, integral part of the application covering all aspects of the applicant's financial profile to ensure that the product is a good "fit." If it is not, it stands to be rejected by the insurer. If it is not completely filled out and signed by both applicant and agent, it will not be considered. By signing, the applicant testifies to his understanding of the contract.

Disclosure, likewise, is extensive in covering all aspects of the annuity to afford the purchaser the opportunity to fully comprehend the product to his satisfaction. The Proposed Rule focuses on "abusive marketing methods to seniors." As noted above, if an agent fails to meet his responsibility to the purchaser, it becomes a question of unprofessional behavior, which is dealt with by the insurer. Adding more layers of disclosure will simply add confusion, not clarity. This is especially so in dealing with seniors, as anyone can attest who has offered these products to that market segment. What seniors want is simplicity, not complexity.

The Release quotes Justice Brennan in that *"...the emphasis in the Securities Act is on disclosure and that the philosophy of the Act is that* ***'full disclosure of the details of the enterprise in which the investor is to put his money should be made so that he can intelligently appraise the risks involved.'"*** Again, we are not dealing with "risks." Sales materials focus on two things: 1) the options available to the purchaser to determine the growth of his annuity, either through a Fixed Interest Account, in which the interest is guaranteed from year to year; or the indexed account, which affords him the opportunity for greater growth with the guarantee against loss...or a combination of the two. And 2) the Surrender Charge period, which varies with the policy based on the benefits afforded: the greater the benefits and guarantees, the longer the surrender charge period. For example, if an up-front bonus is offered, the company must be afforded the time required to regain that amount through its own investments. To repeat, the purchaser is exposed to no market risk whatsoever.

Further evidence that SEC is misapplying the "investment risk" principle is found in the following statement: *"The Commission specifically expressed concern that index feature contracts that adjust the rate of return actually credited on a more frequent basis* [than annually] *operate less like a traditional annuity and more like a security and that they shift to the purchaser all of the investment risk regarding fluctuations in that rate."* Every contract with which I am familiar credits its interest or indexed gains annually. But even if it were more frequent, it would not alter the fact that there is no investment risk involved. Even in the case of Monthly Sum crediting, index fluctuations are captured monthly, averaged, then applied to the contract annually. But whether monthly, annually or otherwise, "investment risk" does not apply.

Page 37757 – **Type of Investment** – Much of the argument in this section provides a major source of contention as well as enlightenment: *"We therefore analyze indexed annuities under the facts and circumstances factors articulated by the U.S. Supreme Court in VALIC and United Benefit. In particular, we focus on whether these instruments...necessitate the 'regulatory and protective purposes' of the Securities Act."* These cases involved variable annuities.

Addressing the *"Need for the Regulatory Protections of the Federal Securities Act"* – *"We also analyze indexed annuities to determine whether they implicate the regulatory and protective purposes of the federal securities laws. Based on that analysis, we believe that the indexed annuities that would be included in our proposed definition present many of the concerns that congress intended the federal securities laws to address. ... Indexed annuities are similar in many ways to mutual funds, variable annuities, and other securities."*

With that statement we heartily disagree! The very nature of those instruments involves investing "in" equity markets in which gains and losses are entirely dependent upon the performance of the market. The overriding concern of the investor is the risk-return trade-off, in which he must measure his appetite for gain vs. his tolerance for risk. Once determined, he can then select among the choices of asset allocation and diversification. Once invested, it is a constant concern about the performance of his funds with much apprehension about losses in a down market.

The purchaser of a Fixed Index Annuity, on the other hand, has no such concern. Since his annuity is guaranteed against market loss, his main concern is a) the surrender charge period relative to his planned use of the funds, which will help him decide on the option of an up-front bonus; and b) his selection of either a fixed interest rate, guaranteed on an annual basis, or one or more indexes with the opportunity for greater gains than the fixed interest account; or a combination of fixed interest and index crediting, in which case he benefits from the guarantee of a minimum rate of return for a portion of the funds, plus the potential for greater gains with the remainder of the funds. He enjoys the peace of mind that comes from knowing he will never lose a penny of his money – guaranteed! His money is not "in" the market. While investors are on a market roller-coaster, his funds just keeps growing. The stark difference between this and market investments is like night and day! How, then, are they *"...similar in many ways...?"*

Page 37758: *"Indexed annuities are attractive to purchasers precisely because they offer participation in the securities markets."* False! As noted above, there is no participation "in" the securities markets. With growth "linked" to the performance of one or more indexes, growth is based on a formula, not an investment.

On the same page: *"Thus, individuals who purchase such indexed annuities are 'vitally interested in the investment experience.'"* (quoting Justice Brennan in U.S. vs. VALIC). Is the Court really "in touch" with those purchasers? As quoted on page 37755 note #24, *"The average age of issuance for indexed annuities has been reported to be 64."* (as of March 2008). It is common knowledge, and strongly recommended by financial advisors and counselors, that as one approaches retirement age, his investment risk must be reduced accordingly, preferably moving his funds into low or zero-risk instruments. Thus, a 64-year old would not be "vitally interested in the investment experience." At that age he cannot afford to lose any of his retirement fund. Many have, with serious financial consequences.

When one combines retirement age with a bear market (especially one like the current one), the prevailing sentiment of seniors is, "I used to ask, 'How much gain can I realize on my investment?' Now, just show me how I can hang on to what I've got!" It is our field experience that seniors' overriding concern is SAFETY, which is not available in *"the investment experience."* That is what overwhelmingly attracts them to Fixed Index Annuities.

To include Fixed Index Annuities under Proposed SEC Rule 151A would be a serious mistake with grave negative impact on insurance companies, agents, and consumers:

- The Rule would add unnecessary and redundant disclosure requirements to the sales process.
- The high expense of adding broker-dealer components to insurance company operations would have to be passed down to consumers in the form of fees they do not currently pay.
- The cost of producing and distributing prospectuses would add to those fees...documents which buyers neither want nor need, the purpose of which is to educate the buyer concerning market risk. There is none! A prospectus is not germane to Fixed Index Annuities.
- It would add considerable confusion to senior's ability to clearly understand these products, resulting in fewer sales, a loss for insurance companies, agents and consumers.
- Some insurance companies would doubtless postpone or waive altogether their option to add a broker-dealer component to their operations.
- This would more than likely impair the availability of Fixed Index Annuities at a time when they are most needed by retiring seniors.
- Fixed Index Annuities are currently used by millions of Americans to help achieve their savings goals, particularly at a time when growing numbers of our population are looking for ways to preserve and increase their retirement nest-eggs in a risk-free environment.
- Making these products less available to the consumer would deprive many from access to them and their valuable principal guarantees.
- In order to market these products as securities, agents would have to incur the expense and time of acquiring and maintaining a securities license. With the advent of Fixed Index Annuities and Index UL products, many agents have no desire to get into (or back into) the securities arena. Again, a loss to seniors looking for these products.

As valid as the above points obviously are, more importantly they would be the result of actions based on erroneous analyses, setting a precedent with far-reaching consequences.

All this places unnecessary burdens on the entire system from provider to consumer. We strive for simplicity. Additional layers of regulations and oversight does the exact opposite, and everyone loses. There is already an enormous overreach by federal bureaucracies into the lives of Americans. We encourage SEC to resist being part of the problem.

In response to your request for comments, it is strongly recommended that Fixed Index Annuities maintain their current status as insurance products, excluded from the requirements of federal regulatory control.

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