(Ref. 17 CFR Parts 230 and 240 [Release Nos. 33-8933, 34-58022; File No. S7-14-08]).

Indexed Annuities (IAs) do offer a challenge as they represent elements of a traditional annuity—exempted from the Securities Act, as well as some potential for enhancing return (excess interest) not existing in traditional annuities. As such, they have lent themselves in the past to overly aggressive and sometimes abusive marketing by some people. I am an insurance agent, who also had about 15 years as a registered rep (although I haven't practiced as a rep for several years). My perspectives grow out ot that experience.
Since they are hybrid products, I think there are several important questions to be answered before classifying them as securities and adding another layer of government control:

- What are IAs more like-- traditional annuities *or* securities. Are they fixed annuities—with principal guarantees and minimum guaranteed interest credits—or do they allow a person to participate in the underlying security? Are they a hybrid version of a fixed annuity that allow the consumer to potentially increase their *interest credited* by tying it to an index, or are they an investment vehicle with the potential for loss inside an annuity wrapper (as variable annuities are)?
- Are sufficient consumer protections available through the states' insurance laws and remedies, and are the states responsive to the marketing abuses that exist with *any* insurance product? Have the states addressed the marketing abuses that have arisen? Is there a need for federal oversight that cannot be sufficiently provided by the states in the future? If the states are capable of regulating this vehicle, does classifying it as a security provide additional value? Does it come at a cost—even impact the consumer that government is trying to serve?

I do not believe we are well served at this point by classifying IAs as a security. Instead, for the combination of reasons below, I think the American citizen is better served by a strong working dialogue between the SEC and the NAIC (National Association of Insurance Commissioners), with the NAIC controlling the product. The SEC/FINRA already has control over how the registered representative markets and sells the product.

1. *Additional Oversight—without additional value added—is detrimental*:

- It bloats govenrmnent, costing the tax-payer, when protection and oversight is already provided by state government. As a practical matter, the controls the SEC/FINRA has already placed on IAs offered by registered representatives under broker/dealers (B/Ds), has already influenced the design of new IAs offered by the insurance companies. There is a trend toward shorter contracts without bonuses.

- Additional Oversight adds extra expenses and delays in filing new contracts—expenses that reduce the interest the carrier can credit to the consumer's account.
- Marketing problems, with this hybrid product, have been generally corrected. There are already a number of consumer protections for insurance products, including advertising and marketing requirements, and remedies to the consumer when these are violated. The NAIC also established additional protections specifically for senior citizens. All of these changes during the past 5 years show the states' insurance consumer protection process works.
- Before adding another duplicative, counter-productive layer of oversight and protection, has the SEC *demonstrated that adequate safeguards can only be provided by making IAs a securities product*. Perhaps a more constructive approach would be for the SEC to express their concerns about consumer protection to the NAIC and let the NAIC continue to use input from all applicable sources to improve IAs.

1. Making IAs a Securities Product, managed exclusively by B/Ds creates its own downsides:

- The broker dealers have been saddled with multiple new compliance requirements in the past few years. This results in higher expenses. As a result, the production levels for brokers continue to rise—pushing some principled producers out of the securities business.
- This also results in less attention being paid to the consumer who doesn't have a lot of money to invest. This is the very person who needs more assistance, as they don't have the resources to hire the professionals who can guide them. Requiring all IAs to be sold as securities will further increase the cost to B/Ds and further exacerbate ignoring the small "invester". IAs provide an important tool for many people preparing for retirement. They provide the potential for a greater inflation hedge than conservative instruments like CDs and fixed annuities, while providing downside principal protection not provided by securities products.
- Moreover, B/Ds are in the business of selling traditional securities. As a result, I fear they will effectively decrease the number of IAs sold and increase the proportion of securities sold to a senior—securities that expose the senior to market loss of principal.
- The sad part of this is that government—in the name of protecting the consumer—is reducing the number of consumers who will be approached and served. So, they're in fact hurting the consumer.

1. Protection of the Consumer's Investment. In reviewing the Supreme Court's decisions on annuity contracts (Section 3(a)(8) of the Securities Act), the SEC discussses Judge Brennan's functional analysis of investment risk: The SEC states, "Justice Brennan noted, in particular, that the emphasis in the Securities Act is on '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.'[32]" The SEC also notes: "Where an investor's investment in an annuity is sufficiently protected by the insurer, state insurance law *regulation of insurer solvency* and the *adequacy of reserves* are relevant. Where the investor's investment is not sufficiently protected, the disclosure protections of the Securities Act assume importance." So several observations are important:

- State-required marketing materials disclose the risks, including the fact that the person is not directly participating in the markets (unlike with securties).
- The investor is putting his money in a contract issued by an insurance company—not into underlying companies. This is a key difference in variable annuities, where the investment rises and falls daily with the changing values of the underlying companies.
- The investor's contract is guaranteed and reserved by the insurance company's General Account, not their Separate Account. This treatment is exactly the same as with the traditional fixed annuities, which the SEC acknowledges are exempt. The insurance company is regulated and monitored by the state to ensure adequate reserves are maintained to satisfy their obligations.
- Aside from contract charges, the investor is guaranteed that the principal *and* any interest previously credited to one's account will not be lost—ever. Again, this treatment is exactly the same as with the traditional fixed annuities. The only risk is how much excess interest will be credited. Just as with traditional fixed annuities, the interest credited will vary from year to year. If the market index is negative during the measuring term, one's interest is 0% (0 is not a loss, just as it is not a gain). And IAs and traditional annuities alike have a minimum guaranteed contract value each year, regulated through the Standard Nonforfeiture Law.

1. Marketing has been a problem, and that has been adequately addressed by insurance companies and the states. There are clear guidelines. As an insurance agent, I must focus on the guarantees an IA provides, rather than promote it as an investment. Likewise, I must refer to the money placed in the contract as a *premium* (since it is an insurance contract), rather than as an investment. Fact finding and suitability requirements parallel that required by the securities industry. Any remaining marketing problems probably more to do with the over-zealous producer. Making it federally regulated won't change that, as one might infer by the multitude of fraud and misrepresentation of products already classified as securities.
2. The SEC states, in adopting Rule 151 in 1986, that IAs don't qualify for the GIC Safe Harbor exemption, because the rate of any interest to be credited in excess of the guaranteed minimum rate (can) be modified more frequently than once per year. Rather than single out all IAs globally,

just apply the GIC rule. That is, if an IA can change more frequently than annually, then subject that one—but not all IAs. (I'm assuming we're talking about the monthly sum approach. Otherwise, all annuities can change the rates for new contracts issued during the year.) Actually, I find this argument confusing. Quite frankly, I don't know any IAs that can change the interest—on a specific contract (account) more frequently. The interest is based on the change in the index at the end of the interest crediting term. The maximum crediting rate is established before the term commences and doesn't change, and the minimum term I've seen is one year. Even the monthly sum approach uses the 12 month period to calculate and credit interest, and the cap on each month's interest is set in advance of the 12 month period. The only exception to this would be with flexible annuity contracts, which permit multiple (e.g., monthly) payments. The flexible payment contracts that permit the payment to go into the indexed account before the contract anniversary can change the maximum interest rates on (the new) money invested during subsequent months. However, once applied to the contract, the interest crediting rates and choices can't be changed during its 12 month (or longer) interest crediting period. Note: this is no different than how traditional (exempted) flexible payment annuities are treated; a new interest rate can be declared for new premiums.

3. The SEC states (Need for the Regulatory Protections of the Federal Securities Acts), "IAs are similar in many ways to mutual funds, variable annuities and other securities." I don't know of any of these instruments that protect the invested principal against a loss of the markets during one's lifetime. And except for VAs, they don't protect at one's death either. Another difference is that a person may reallocate funds among investment options in mutual funds and VAs daily. Allocations in IAs can only be reallocated at the end of the interest crediting period (one year or longer). Therefore, I must disagree with this statement of similarity. IAs are not similar to these investment alternatives, although they do provide *some* of the potential for enhancing excess interest credited when compared to traditional fixed annuities.
4. Two paragraphs later, the SEC states that they believe Congress' objective in the Securities Act apply to contracts "when the amounts payable by an insurer under an indexed annuity contract are more likely than not to exceed the guaranteed amounts." Outside of immediate annuities, this statement would apply to about 95% of all traditional fixed annuities at the time of issue—contracts which the SEC recognizes are clearly not securities. That is, when issued, their current interest rate is almost always above the guaranteed minimum interest rate.

To conclude, I think IAs are a special type of a fixed annuity, with some enhanced potential, and not a security. They are similar contracts, with the attendent guarantees of a fixed annuity. In both, the risk is borne by the insurance company, and they maintain the reserves required to honor those

guarantees. The interest is determined by reference to an external index, but the consumer does not participate in a security—which I think was the concern in Congress passing the Securities Acts. The guaranteed interest and minimum guaranteed contract values operate a little differently than traditional annuities, but that is the trade-off for the enhanced interest potential.

Likewise, I think the NAIC, the state insurance departments, and the insurance companies have demonstrated their ability to work to correct some of the prior marketing abuses—eliminating much of the value of making IAs a securities product. In addition to the insurance laws for protecting the consumer, sufficient remedies exist when violation of insurance statutes occur.

However, should IAs be classified as a security, I think the proposed definition is far too encompassing. It states, "An annuity is not an 'annuity contract' or 'optional annuity contract' under Section 3(a)(8) of the Securities Act if amounts payable by the issuer under the contract are calculated, in whole or in part, *by reference to the performance of a security*. Many traditional fixed annuities—which the SEC recogizes as being exempt use something known as a MVA (market value adjustment), as a way of slightly boosting the interest declared. If a person surrenders the contract while the MVA applies, there is an additional (charge)—tied to interest rate changes <u>in a published index</u>. So by the SEC definition, many traditional deferred annuities—that are currently exempt by their conservative nature should also be included.

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