September 10, 2008

Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F. Street N.E.
Washington D.C. 20549-1090
File Number: S7-14-08

Dear Chairman Cox:

We write as the officers of the National Association of Insurance Commissioners (NAIC) and respectively submit these comments on the proposed rule issued by the Securities and Exchange Commission (SEC) which is intended to define the terms "annuity contract" and "optional annuity contract" under the Securities Act of 1933. The proposed rule also would add an exemption for certain insurance companies from filing reports under the Securities Exchange Act of 1934 with respect to indexed annuities and other securities that are registered under the Securities Act. You may receive additional comments from individual state departments of insurance.

General Comments

We are sending you this letter as a formal request to withdraw the SEC proposed rule on indexed annuities and certain other insurance contracts or, at the very least, delay its adoption given state insurance regulators' past activities to date in this area and what we are currently doing. This rule is not needed. If it is adopted, we feel that our current activities to address emerging issues concerning indexed annuities will be delayed or lose momentum altogether because states and the insurance industry will have to shift their focus to complying with your rule. This would not be in the best interest of the consumers that state insurance regulators and the SEC both wish to protect.

As we have described in our previous letters to you, state insurance commissioners, all of whom are NAIC members, have for many years clearly believed and have treated indexed annuities as insurance under their state laws subjecting the products, the companies and producers selling these products to state insurance regulatory oversight. As part of our mission to facilitate the fair and equitable treatment of insurance consumers, insurance products, including indexed annuities, are subject to a myriad of state insurance laws, not just those that relate to insurance company solvency. Those laws include state insurance advertising laws, replacement laws and producer licensing and continuing education laws among others. Thirty-three states have adopted the NAIC Advertisements of Life Insurance and Annuities Model Regulation or related legislation or regulations. This model sets forth minimum standards and guidelines to assure a full and truthful disclosure to the public of all material and relevant information in the advertising of life insurance policies and annuity contracts. Likewise, a large number of states, 43 to date, have adopted the NAIC Life Insurance and Annuities Replacement Model Regulation or something similar. This model regulates the activities of both insurance companies and producers with respect to the replacement of existing life insurance and annuities. To protect the interest of life insurance consumers, it also establishes minimum standards of conduct that must be followed regarding replacement transactions to ensure that insurance consumers receive sufficient information to make a decision in his or her best interest regarding a

replacement and to reduce the opportunity for misrepresentation and incomplete disclosure. We also want to draw your attention to the NAIC state insurance producer licensing and continuing education laws. Every state ensures a minimum level of competency for producers by requiring producers to pass a test, answer background check questions as part of the application process and obtain a license prior to selling, soliciting or negotiating life insurance and annuity products. As part of this process, some states also require producers to complete pre-licensing education. In addition, all states require insurance producers to complete ongoing continuing education to maintain this license. Finally, some states, like Iowa, mandate specific indexed product training before producers are allowed to sell indexed products.

In the proposed rule, it is suggested that one main reason for its promulgation was to bring indexed annuities under the protection of the federal securities laws because these products are not being sufficiently regulated by state insurance regulators. We would disagree with this premise. We wish to call your attention to the specific efforts of NAIC members in the last two years to increase oversight of the sale of indexed annuities and the efforts undertaken by the industry to raise standards relating to the sale of these products to all purchasers. Those efforts are having beneficial effects on sales transactions and are leading to further reforms as we have highlighted below.

The NAIC has developed model laws and regulations, bulletins and a "Buyer's Guide to Annuities" to assist consumers in purchasing indexed annuities and to assist state insurance commissioners with the regulation of indexed annuities. To date, 33 states have adopted the NAIC Suitability in Annuity Transactions Model Regulation or related legislation. In addition, 22 states have adopted the NAIC Annuity Disclosure Model Regulation or related legislation. Most insurance companies follow this model as a standard throughout the country. The Buyer's Guide to Annuities includes a section on indexed annuities. A small group of regulators are currently updating the Buyer's Guide to Annuities to enhance the information provided to consumers about indexed annuities.

In June, the NAIC approved a national alert to warn older consumers to question the alleged credentials of some advisors to seniors. A Producer Bulletin was also approved to remind producers of their responsibilities to only sell suitable annuities and not to misuse their senior designation certifications. All of these efforts place the burden on insurance companies to make certain the requirements are being followed by producers. Some of our members, like the Kansas Department of Insurance, have already issued similar alerts and bulletins and posted them on their Web sites. In July, the NAIC Life Insurance and Annuities Committee adopted a model regulation on the use of senior-specific certifications and professional designations in the sale of life insurance and annuity products. This model regulation is patterned after the North American Securities Administrators Association (NASAA)'s recently adopted rule. The full NAIC membership is scheduled to adopt this new model at the NAIC meeting in Washington, DC later this month. As you see, the NAIC and its members take very seriously their responsibility to safeguard insurance consumers and particularly, to protect vulnerable seniors.

We also want to make you aware of some unique state initiatives. Earlier this year, Iowa teamed with the American Council of Life Insurers (ACLI) in a pilot project to assure adequate disclosures are uniformly made to consumers on annuity sales under the model disclosure regulations. Seventeen companies are participating in Iowa's pilot project and using the template disclosure form for all or some of their annuity products (indexed and otherwise) throughout all states. This pilot project will be evaluated for its usefulness to both insurance producers and consumers. If the disclosure templates prove to be useful, then the pilot project could be extended to include additional states later this year. In 2007, Wisconsin created an annuity sales supervision advisory committee charged with establishing standards for insurer supervisory systems in the sale of annuity products. Also, we note New Hampshire joined Iowa, Missouri and Illinois earlier this year in encouraging the Insurance Marketplace Standards Association (IMSA) to establish "best practices" for the supervision of annuity transactions. It is anticipated that IMSA will issue a final report later this

month. IMSA has already established best practices for the suitability of annuity sales and the disclosure of all annuity products sold and for agent training.

The NAIC Life Insurance and Annuities Committee identified annuity suitability as a priority for the Committee and created a working group that is reviewing and considering changes to the NAIC Suitability in Annuity Transactions Model Regulation to improve the regulation of annuity sales and to provide insurers uniform guidance in developing agent training, supervision and monitoring standards in order to better protect annuity consumers from unsuitable sales and abusive sales and marketing practices. As it works to develop recommendations, this working group has reached out to the Financial Industry Regulatory Authority (FINRA) and others in the regulator and regulated community in a collaborative effort to resolve any issues it discovers during its review of the NAIC model that may need to be addressed.

In June, the NAIC Life Insurance and Annuities Committee established a new working group to look at revising the NAIC Annuity Disclosure Model Regulation to improve the disclosure of information provided for annuity products, both generally and specifically, and to provide insurers uniform guidance in developing disclosure information and documents and monitoring distribution thereof in order to better inform annuity consumers about the annuity product purchased and how it works. This working group will also examine an emerging concern with the use of illustrations in annuity sales and solicitation. We, as state insurance regulators, intend to proactively examine the manner in which illustrations are being used and whether such use is appropriate.

<u>Specific Comments</u>

In the proposed rule, you ask for comments on a number of specific questions. If you choose not to withdraw the proposed rule or delay its adoption, please accept our comments below on those questions of particular interest to us as state insurance regulators. However, we would respectively request the right to comment in more detail at a later date.

As we have noted in our Aug. 14, 2008 letter to you, we are in the process of conducting a data call of the top insurance companies selling indexed annuities. The purpose of the data call will be to provide additional detail on the sales and marketing practices of these insurance companies. We have convened a small group of our members to review and analyze the information we receive from this data call to determine additional information we can share with you on how states regulate indexed annuities and any current or emerging issues in the marketplace.

<u>Scope of the Proposed Definition (§230.151A (a))</u>

Section 230.151A(a) would apply to a contract that is issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia. Among the specific questions you ask regarding the scope of the proposed definition is whether it should apply to other forms of insurance other than annuities, such as life insurance or health insurance. We answer "No" it should not. Life insurance is clearly within the purview of state insurance laws and regulations and should remain so. The regulation of individual health insurance plans and policies has always been within the purview of state insurance regulators. In addition, although employee welfare benefit plans are subject to dual federal and state regulation under the Employee Retirement Income Security Act of 1974 (ERISA), states have the authority to regulate those plans that provide health benefits through an insurer. Also, we note that health insurance is not an investment product. The insured is entitled to benefits agreed to in accordance with the health insurance contract. As such, the SEC should not extend its proposed definition to health insurance.

Definition of “Annuity Contract” and “Optional Annuity Contract” (§230.151A (a))

Section 230.151A(a) proposes that an annuity issued by an insurance company would not be an “annuity contract” or an “optional annuity contract” under Section 3(a)(8) of the Securities Act (15 U.S.C. 77c(a)(8)) if the annuity has the following two characteristics: First, the amounts payable by the insurance company under the contract are calculated, in whole or in part, by reference to the performance of a security, including a group or index of securities; second, amounts payable by the insurance company under the contract are more likely than not to exceed the amounts guaranteed under the contract. If the annuity meets both of these characteristics, then the proposed rule would classify it as a security. As acknowledged in the commentary for the proposed rule, indexed annuities have a guaranteed minimum value. That is the reason why this product is an insurance product and not a security. The principal is guaranteed. The index is used to determine the crediting rate of interest to the account, and does not affect the account value directly as in a variable annuity, so the insured does not bear the investment risk directly. In addition, once the interest is credited to the policy, it becomes guaranteed and the company is now at risk to pay that also. There are surrender charges, but this is true of a standard fixed annuity as well.

The proposed rule defines an indexed annuity as not being annuity contract within the meaning of Section 3(8) of the Securities Act if the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract. This would also be true for standard fixed annuities. Although there is a minimum guaranteed interest rate underlying the contract, fixed annuities also use a declared interest rate that is higher than the minimum guarantee. Policyholders will get letters announcing new rates going forward. The contract does not contain language as to how the carrier will determine this rate. A key difference with the indexed annuity is that the contract describes how this rate is determined (i.e. tied to an index). Whereas variable annuities are in separate accounts, the indexed annuity is typically in the general account of a carrier as are standard fixed annuities. The insurance carrier bears the investment risk, not the owner.

Determining Whether an Annuity Is Not an “Annuity Contract” or “Optional Annuity Contract” under Proposed Rule 151A (§230.151A (b))

Section 230.151A(b) requires an insurer to make a determination of the more likely than not test at or prior to issuance of a contract and that determination would be conclusive if: (a) both the methodology and the economic, actuarial and other assumptions used in the determination are reasonable; (b) the computations made by the issuer in support of the determination are materially accurate; and (c) the determination is not made more than six months prior to the date on which the form of contract is first offered and not more than three years prior to the date on which the particular contract is issued. You have asked a number of questions related to these determinations to be made by insurers. We do not have specific comments on these questions other than to state that additional guidance may need to be included to ensure the integrity of these determinations. It is not clear within your proposed rule which regulator is going to determine whether or not a company is in compliance with the requirements.

Annuities not Covered by the Proposed Definition (§230.151A (a))

Section 230.151A(a) proposes that an annuity issued by an insurance company would not be an “annuity contract” or an “optional annuity contract” under Section 3(a)(8) of the Securities Act if the annuity meets certain specified characteristics as discussed above. You ask whether the proposed regulation should include a safe harbor under Section 3(a)(8) of the Securities Act for any annuities under which amounts payable by the insurance company are calculated by reference to the performance of a security. We believe that a safe harbor is not necessary. The current exemption under Section 3(a)(8) of the Securities Act provides this safe harbor.

Exchange Act Exemption for Securities that are Regulated as Insurance

In addition to the proposed new rule in §230.151A, the SEC is proposing new rule §240.12h-7. Section 240.12h-7 would exempt an insurer from the reporting requirements under Section 13(a) of the Exchange Act (15 U.S.C. 78m(a)) with respect to securities that are required to be registered under the Securities Act of 1933. You request specific comments on whether this exemption from the reporting requirements for securities that are regulated insurance under state law is appropriate. We believe that this exemption is appropriate for the reasons stated in the proposed rule. One main goal of insurance regulators is to ensure the financial solvency of insurance companies. As such, the reporting requirements under the Exchange Act would be duplicative and impose unnecessary regulation. However, we would also like to point out that insurance regulators also have another equally important goal—to protect insurance consumers. As we have outlined above, the NAIC and its members have a strong record in this area, in addition to ensuring the financial solvency of insurance companies.

We do have one suggestion, however, for this part of your proposal. We suggest that the scope of this exemption be expanded to permit licensed insurance producers to keep selling those products that would, under the proposed rule, no longer be exempt from Section 3(a)(8) of the Securities Act, without having to obtain a securities license. As we have noted in our general comments above, state insurance producer licensing and continuing education laws already provide strong consumer protections for this product. Requiring an additional securities license for insurance producers to sell this product is unnecessary.

We appreciate the opportunity to submit comments on the proposed regulation. We urge you, however, to withdraw the proposed rule or, at the very least, delay its adoption. As the NAIC officers and as State Insurance Commissioners, we would be pleased to meet with you to discuss the extensive and ongoing regulatory initiatives taken by state insurance commissioners to regulate the sale of indexed annuities and other annuities.

Sincerely,

Sandy Praeger
Kansas Insurance Commissioner
NAIC President

Roger A. Sevigny
New Hampshire Insurance Commissioner
NAIC President-Elect

Jane L. Cline
West Virginia Insurance Commissioner
NAIC Vice President

Susan E. Voss
Iowa Insurance Commissioner
NAIC Secretary-Treasurer

cc: Kristin Kaepplein
U.S. Securities and Exchange Commission