SAMMONS
ANNUITY GROUP
A member of the SAMMONS FINANCIAL GROUP

Esfandyar E. Dinshaw
President
Phone: (515) 440-5560 • Fax: (515) 440-5599

September 10, 2008

Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: **Comment on Proposed Rules 151A and 12h-7**
File Number S7-14-08
Release Numbers 33-8933 and 34-58022

Dear Ms. Harmon:

Midland National Life Insurance Company ("Midland" or "we") is submitting this letter in connection with Proposed Rule 151A under the Securities Act of 1933 and Proposed Rule 12h-7 under the Securities Exchange Act of 1934 (the "Proposed Rules").[1] The Proposed Rules, if adopted, would operate to exclude certain fixed indexed and other annuity contracts from the exemption provided by Section 3(a)(8) of the Securities Act of 1933, thereby requiring registration of such contracts with the Commission and securities licensing of all salespersons, and provide a conditional exemption for insurance companies issuing such contracts from filing periodic reports under the Securities Exchange Act of 1934. As noted in the Proposing Release, this proposed rule is "intended to clarify the status under the federal securities laws of indexed annuities, under which payments to the purchaser are dependent on the performance of a securities index."[2] As set forth below, we are opposed to Proposed Rule 151A.

Midland is a major issuer of fixed indexed annuities. During 2007, Midland and its affiliate, North American Company for Life and Health Insurance ("North American"),[3] received $2,790,305,000 in premium on fixed indexed annuities. Midland (but not North American) also issues variable annuities, and during 2007 it took in $142,033,000 in variable annuity premium. Midland is one of the few companies that issues substantial amounts of both fixed indexed and variable annuities.

Midland supports the Commission's ongoing efforts to enhance consumer protection and its efforts to provide greater certainty to issuers and sellers of annuity products, including fixed

---

[1] *See Indexed Annuities and Certain Other Insurance Contracts*, Rel. Nos. 33-8933, 34-58022 (June 25, 2008), File No. S7-14-08 (the "Release").

[2] *Id.* at 1.

[3] Midland and North American are under common ownership. Both companies utilize the same compliance policies and procedures, including the same disclosure, suitability, and customer service standards and policies. As used herein, "Midland" or "we" includes both companies.

indexed annuities, with respect to their obligations under the federal securities laws. Midland believes strongly that there is no place for inappropriate sales practices involving fixed indexed or other fixed annuities, just as with any investment or other insurance products and services.

However, with respect to proposed rule 151A, classifying all fixed indexed annuities as securities, as the proposed rule would do,[4] is not necessary to ensure a well-policed, well-regulated market with robust consumer protection. Moreover, doing so is contrary to a statutory exemption, as interpreted and applied by the U.S. Supreme Court.

I. Background

A. The Section 3(a)(8) Exclusion

Section 3(a)(8) of the Securities Act of 1933 (the "Act")[5] exempts from the registration provisions of the Act any annuity contract (or optional annuity contract) issued by an insurance company subject to the supervision of a state insurance commissioner (or similar entity or official). The legislative history of Section 3(a)(8) indicates that "[i]nsurance policies are not to be regarded as securities subject to the provisions of the Act. The insurance contract and like contracts are not regarded in the commercial world as securities offered to the public for investment purposes."[6] Indeed, the Supreme Court, the Commission and commentators view Section 3(a)(8) as an exclusion from all provisions of the Act.[7] Thus, to the extent that an annuity contract is entitled to rely on Section 3(a)(8), it would be excluded from the antifraud

---

[4] The Commission assumes "that all indexed annuities that are offered will be registered." Release at 64.

[5] Section 3(a)(8) of the Act provides:

> Section 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities: . . .
>
> (8) Any insurance or endowment policy or annuity contract or optional annuity contract, 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[.]

[6] H.R. Rep. No. 85, 73d Cong., 1st Sess. 15 (1933).

[7] *See* Tcherepnin v. Knight, 389 U.S. 332, 342 n.30 (1967) (dictum) ("the exemption from registration for insurance policies was clearly supererogation"); Berent v. Kemper, 780 F. Supp. 431, 440-41 (E.D. Mich. 1991) ("Insurance policies that come within Section 3(a)(8) are excluded from the anti-fraud provisions of all federal securities laws"); L. Loss, Fundamentals of Securities Regulation 204 (1988). In proposing Rule 151 under the Act, the Commission concurred with the view that any contract falling within the provisions of Section 3(a)(8) is not merely exempt from registration but also is *excluded* from all provisions of the Act. See Definition of Annuity Contract or Option Annuity Contract, Securities Act Release No. 6558, [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,710 at 87,160 (Nov. 21, 1984) ("Release 6558") (proposing Rule 151, the "safe harbor" rule under Section 3(a)(8)). The Commission later affirmed this view in its Concept Release on Equity Indexed Insurance Products. *See* Equity Index Insurance Products, Securities Act Release No. 7438, [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,957 (Aug. 20, 1997) at 89,815 n.17 ("SEC Concept Release"), and it so noted again in the Release.

provisions of the Act, and should also be excluded from the antifraud provisions of the Securities Exchange Act of 1934.[8]

Judicial and administrative interpretations have stressed, however, that not every product labeled as an annuity is entitled to rely on Section 3(a)(8).[9] Each instrument, including hybrid insurance products that combine fixed and variable elements, "must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole."[10]

In determining whether a particular insurance product is exempt under Section 3(a)(8), courts and the Commission have focused on three key factors in relation to the product:

- the allocation of investment risk between the insurer and the contract owner;
- the manner in which the product is marketed, *i.e.*, whether the product is being promoted primarily as insurance or primarily as an investment; and
- whether the insurer assumes a meaningful mortality risk.[11]

However, proposed Rule 151A completely disregards and is in fundamental conflict with this well-established body of law.

B. Proposed Rule 151A

Proposed rule 151A would define a class of annuity that would be deemed <u>not</u> to be an annuity or optional annuity within the meaning of Section 3(a)(8) of the 1933 Act. The proposed rule has two prongs. The first prong determines whether the rule applies (*i.e.*, is the annuity "indexed" in some fashion) and the second would then be applied to determine if the annuity comes within the definition of "not" an annuity. Specifically, under proposed rule 151A, an annuity would be a security if:

---

[8] *See e.g.*, <u>Olpin v. Ideal Nat'l Ins. Co.</u>, 419 F.2d 1250 (10th Cir. 1969) (life insurance policies were not securities under the Act, so there can be no cause of action under the antifraud provisions of the Exchange Act).

[9] The Supreme Court has clearly held that "the meaning of 'insurance' or 'annuity' under these Federal Acts is a federal question." <u>S.E.C. v. Variable Annuity Life Insurance Co. of America</u> ("VALIC"), 359 U.S. 65, 69 (1959).

[10] <u>Marine Bank v. Weaver</u>, 455 U.S. 551, 560 n. 11 (1982) (holding that the contracts in question, a certificate of deposit and a business agreement whereby one party received shares of the other party's profits in exchange for providing a bank loan guarantee, were not securities).

[11] *See* <u>VALIC,</u> *supra* n. 9; <u>SEC v. United Benefit Life Ins. Co.,</u> 387 U.S. 202 (1967) ("United Benefit"); <u>Olpin v. Ideal Nat'l Ins. Co.,</u> 419 F.2d 1250 (10th Cir. 1969); <u>Peoria Union Stock Yards Co. v. Penn Mutual Life Ins. Co.,</u> 698 F.2d 320 (7th Cir. 1983); <u>Otto v. Variable Annuity Life Ins. Co.,</u> 814 F.2d 1127 (7th Cir. 1986), <u>rev'd on rehearing</u>, 814 F.2d 1140 (1987), <u>modified,</u> (1987), <u>Cert. denied</u>,486 U.S. 1026 (1988); <u>Associates in Adolescent Psychiatry v. Home Life Ins. Co</u>., 941 F.2d 561 (7th Cir. 1991), <u>cert. denied,</u> 502 U.S. 1099 (1992); <u>Berent v. Kemper Corp.</u>, 780 F.Supp. 431 (E.D. Mich. 1991), <u>aff'd</u>, 973 F.2d 1291 (6th Cir. 1992); <u>Dryden v. Sun Life Assurance Co. of Canada</u>, 737 F.Supp. 1058 (S.D. Ind 1989), <u>aff'd without opinion</u>, 909 F.2d 1486 (7th Cir. 1990); <u>Rothwell v. Chubb Life Ins. Co. of America</u>, 191 F.R.D. 25 (D. N.H. 1998); <u>Malone v. Addison Ins. Mktg. Inc</u>., 225 F.Supp.2d 743 (W.D. Ky. 2002) ("Malone").

(1) Amounts payable by the issuer under the contract are calculated, in whole or in part, by reference to the performance of a security,[12] including a group or index of securities; and

(2) Amounts payable by the issuer under the contract are more likely than not to exceed the amounts guaranteed under the contract.[13]

The second prong purports to measure, or at least reflect, the investment risk borne by the purchaser.

The status under the 1933 Act of annuities that fall outside the definition (*i.e.,* are not "not an annuity") "would continue to be determined by reference to the investment risk and marketing tests articulated in existing case law under Section 3(a)(8) and, to the extent applicable, the Commission's safe harbor rule 151."[14]

II. Proposed Rule 151A Is Based on Faulty Premises

The premises on which Proposed Rule 151A are based, as discussed in the Release, are faulty in a number of respects. The premises are faulty with respect to (A) state insurance regulation of fixed indexed (and other) annuities, (B) allegedly excessive complaints about fixed indexed annuities, and (C) the reasons why consumers purchase fixed indexed annuities.

A. State Insurance Standards for Disclosure and Consumer Protections are Comprehensive and Growing; Rule 151A Would Impose a Duplicative, Unnecessary, and Expensive Regulatory Scheme In An Area Already Subject to Comprehensive Regulation

1. <u>State Regulatory and Other Industry Requirements and Standards</u>

The Release evidences a belief that state insurance regulation of fixed annuities is concerned primarily, if not solely, with insurance company solvency, *i.e.,* the insurer's financial ability to satisfy its contractual obligations to policy owners. The Release does not, however, recognize the thorough state regulation of fixed indexed annuities, of the companies that issue them, and of the individuals who sell them. In evaluating the need for the regulatory protections of the federal securities acts and in conducting a cost/benefit analysis,[15] the Commission should take into account the nature, extent and effectiveness of state insurance disclosure and sales practices regulation applicable to fixed indexed annuities.

The Release states that state insurance regulation "is focused on insurance company solvency and the adequacy of insurers' reserves."[16] The Release refers to state insurance

[12] Security would have the same meaning it has in Section 2(a)(1) of the 1933 Act. Release at 32.

[13] Release at 93-94.

[14] Release at 46.

[15] *See* Release at 27-28, 68-74.

[16] Release at 48.

regulatory requirements relating to minimum levels of capital, surplus, and risk-based capital; general account investment restrictions; and risk limitations and valuation requirements. That solvency regulation is particularly relevant and important for all fixed annuities, including indexed annuities, where (i) purchasers are afforded the protections of state non-forfeiture laws providing for significant minimum amounts to be paid upon early termination, and (ii) the assets supporting the annuity reserves are not maintained in insulated separate accounts.

However, the Release fails to recognize, or take account of, the fact that state insurance regulation is much broader and more comprehensive than just solvency regulation. In most states, there are thorough regulatory requirements covering the following areas:

- Suitability reviews;
- "Free Look" periods;
- Annuity disclosure requirements;
- Advertising;
- Unfair trade practices;
- Regulation of replacements (exchanges of one annuity for another);
- Market conduct reviews of insurers;
- Levels of consumer guarantees in annuities;
- Agent licensing and training;
- Insurance agent penalties for violations of sales rules;
- Non-forfeiture laws;
- Guarantee fund laws;
- Policy form requirements.

These and other requirements apply with respect to fixed indexed annuities just as they apply with respect to more traditional fixed annuities. The Release, and Proposed Rule 151A, fail to recognize or take account of these many areas of state insurance regulation and consumer protection.

Moreover, in recent years state insurance regulators have been engaged in, and devoting considerable resources to, strengthening sales and disclosure practices relating to annuities, including fixed indexed annuities. In 2003, the National Association of Insurance Commissioners ("NAIC") adopted the Senior Protection in Annuity Transactions Model Regulation to require insurer oversight of the suitability of annuity sales to persons over age 65. In 2006, with the support of the annuity industry, the NAIC expanded the model suitability regulation to all ages and renamed it the Suitability in Annuity Transactions Model Regulation.[17] The NAIC suitability model regulations go beyond FINRA's suitability rule, Rule 2310, by imposing a specified supervisory role on insurers with regard to the suitability of annuity sales.

---

[17] The NAIC Suitability in Annuity Transactions Model Regulation is a robust regulatory scheme, establishing standards and procedures governing recommendations made to consumers that result in annuity transactions, to ensure "that insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed." The regulation imposes on insurers and insurance producers the requirement for maintaining written procedures and conducting periodic reviews that are reasonably designed to assist in detecting and preventing violations of the model act.

With active support from annuity writers and FINRA,[18] these suitability regulations now have been adopted in more than 33 states.

Industry groups, such as the ACLI and the Association for Insured Retirement Solutions, have been actively working with, and making presentations to, the NAIC, FINRA and the SEC to develop and promote short-form, plain English disclosure templates that harmonize and simplify the disclosures provided to annuity purchasers.[19] These disclosures are much more appropriate for fixed indexed annuities and much more user and consumer friendly, than the prospectus that would be required if fixed indexed annuities were registered as securities.[20]

The disclosure templates are designed to comply with the NAIC's Annuity Disclosure Model Regulation, adopted in 22 states. This regulation seeks to ensure that purchasers of all annuity contracts understand the basic features of the annuity contract, such as surrender and transaction fees, annuity benefits and other guarantees. Both the consumer and insurance agent are often required to sign these disclosure statements as a condition of policy issuance. Many states also require insurers to deliver a buyer's guide, written by the NAIC, at the point of sale for fixed annuities and for equity-indexed annuities. These state-mandated disclosure standards, specifically designed for fixed indexed annuities, are more effective than SEC mandated prospectuses, which have been criticized as too complex and lengthy.

Efforts to improve disclosures to customers and enhance sales practices across all annuities has been supported by CEOs from all sectors of the life insurance industry. The ACLI has created its CEO Task Force on Annuities that works to support consumer empowerment through improved simplified disclosure for fixed and indexed annuities based on the NAIC annuity disclosure model and based on the short-form template for variable annuities that complies with federal securities laws.

Improved agent training and supervisory standards are a recognized priority at the state insurance level. Some states already require agents to complete specific FIA training. For example, Iowa requires the completion of a four-hour training course specific to indexed products and that each insurer have a system in place to verify compliance with the training requirement.[21] State insurance regulators have charged the Suitability in Annuity Sales Working Group of the NAIC's Life and Annuity "A" Committee with developing uniform guidelines for insurers to use in developing agent training, supervision and monitoring standards to better

[18] In May 2007, the NASD released a statement that it issued jointly with state regulators from North Dakota, Iowa and Minnesota in support of the NAIC Model Annuity Suitability Regulation. This statement is the first significant initiative of the Annuity Working Group, which was established by the Minnesota Department of Commerce and the NASD following the May 2006 Annuity Roundtable to evaluate the regulatory standards applying to annuities.

[19] These documents pass the "Flesch" test, a test that all annuity contracts must pass and that analyzes the document for reader comprehension at the 10th grade level.

[20] *See* discussion below regarding Form S-1 registration statement requirements.

[21] Iowa Admin. Code § 191-15.82, 15.84.

protect annuity consumers from unsuitable sales and abusive sales and marketing practices.[22] The "A" Committee also has under consideration a model NAIC regulation to prohibit the misleading use of senior-specific certifications and designations by agents in the solicitation, sale or recommendation of a life insurance or annuity product.

Consumers of annuity products are also protected by the NAIC Insurance and Annuity Replacement Model Regulation. Adopted in 43 states, this model regulation requires insurers to develop systems of supervision, control, monitoring and recordkeeping, and to provide consumers with plain-English notices and signed disclosure documents, if a replacement or financed purchase transaction occurs.

In addition to complying with the substantive state insurance regulations applicable to annuity products, annuity writers must undergo market conduct examinations by the insurance regulator in their state of domicile, as well as by any other state in which they do business. The scope of market conduct exams is wide-ranging and is focused increasingly on product suitability and the corrective measures and amount of fines imposed on insurers may be significant. In addition, annuity writers are subject to state unfair trade practice statutes which prohibit the misrepresentation of product terms and conditions, and are within the jurisdiction of their state attorney generals, several of whom have brought high profile enforcement cases alleging unsuitable sales and replacements of fixed and indexed annuities to seniors.

For all of these reasons, the Release is based on faulty premises as to the nature and extent of state regulation of fixed indexed annuities.

2. Midland's Standards and Practices

As discussed above, every state has a full body of laws and regulations governing insurance, including consumer protection, sales, and unfair trade practice laws. Over 33 states have adopted either the NAIC Suitability in Annuity Transactions Model Regulation (in its current or prior form) or similar state regulation. This type of regulation helps to ensure that an insurance producer recommends suitable annuity contracts based on relevant investment, tax, financial, and customer information. Additionally, these regulations afford state insurance regulators with the ability to protect consumers against inappropriate or unsuitable annuity sales practices.

For practical reasons, and for administrative systems reasons, it is simply not feasible to apply different disclosure, suitability, and other standards in each jurisdiction, according to that state's particular requirements. Therefore, in general, Midland takes a "highest common denominator" approach and applies the highest standards, or best practices, uniformly on a nationwide basis.

---

[22] The ACLI is developing Suitability Monitoring Standards for insurers to use to uniformly implement the supervisory procedures in the NAIC Suitability Model Regulation. These Suitability Monitoring Standards, which would be applicable to the sales of all annuities, build upon SEC and FINRA rules and guidance on supervisory "best practices" in an effort to promote consistent protections for annuity customers, including the recommendations in the Joint SEC/NASD Report on Examination Findings Regarding Broker-Dealer Sales of Variable Insurance Products (June 2004).

a. *Suitability*

As part of Midland's uniform compliance policies and procedures, for example, we require the same Annuity Suitability Form in all states, for all ages, for all deferred annuity contracts. We require that such a form be signed by both the owner and the agent for every contract sold. We monitor legislation, regulation and insurance department bulletins, and constantly review our suitability form and process to ensure that we are in compliance with each state's insurance department regulations.

Our "one form all states all ages" approach to suitability allows us to consistently apply our review standards and provide the same level of supervision to all consumers across the country. This approach also requires that our licensed independent brokers routinely investigate the unique financial situation of *every* applicant, disclose the key product features of the proposed annuity, and determine whether it is suitable for the prospective applicant. For this purpose, we require a Suitability Form for every annuity sale, which must be signed by both the purchaser and the agent. Suitability, by its very nature, is not black and white. Every consumer has a unique financial picture (income, expenses, savings, etc.), risk tolerance, time horizon, and investment objective. Our suitability review program allows us to monitor every annuity application, including a heightened review process triggered by a variety of customer information indicators. We employ a team of specially trained home office employees who conduct heightened suitability reviews of applications flagged based on responses to the suitability form.

Like most other annuity products on the market, Midland's fixed indexed annuities have surrender charges and, as indicated above, may not be suitable for all potential purchasers. In this regard, the Release indicates a special concern with unsuitable sales to seniors. With respect to sales of fixed indexed annuities to seniors, Midland utilizes a special supervision and review process. For every sale of a fixed indexed annuity to an owner age 65 or older, Midland home office personnel call the new owner to make sure he or she understands the product they have purchased and are satisfied with it (of course, every purchaser of an annuity product has a "free look" right to return the product and rescind the purchase, for a limited time period). Moreover, a meaningful effort is made to actually reach the owner – if necessary, two calls are made. If the owner has still not been reached, a letter is then sent to the owner requesting that he or she contact Midland to discuss any questions or concerns**.** (See *Customer Satisfaction Survey Programs,* below).

b. *Disclosure*

Over 20 states have adopted the NAIC's Annuity Disclosure Model Regulation (in its current or prior form) or similar state regulation, which requires an insurer or insurance producer to disclose, at a minimum, specified information about the annuity contracts they are selling. We create a unique Annuity Disclosure Statement form for each of our annuity contracts, disclosing a variety of information about the contract, including but not limited to guarantees and crediting methods, liquidity options (commonly known as penalty-free withdrawals), premium bonus (if any), annuitization options, payment of agent commissions, optional riders (if any) and death benefits. In addition, each Annuity Disclosure Statement requires the applicant to initial the form next to the annuity contract's surrender charge schedule and surrender charge period. Our

Annuity Disclosure Statement is required with every annuity application in all states and must be signed by the applicant and licensed independent broker.

Attached as Exhibit A is our uniform Annuity Disclosure Statement for our principal fixed indexed annuity. A few things should be noted about this disclosure form. First, it begins with a reference to "without the risk of losing premium due to market volatility" and it does not emphasize the possibility of index-based interest crediting, showing that the product is sold on the basis of safety, not as an investment in the market. Second, on the first (of two) pages, the Surrender Charges section is as prominent as any other. Third, although this is only a two-page document, the four surrender charge schedule options are disclosed prominently, in a box. Moreover, the purchaser must choose a surrender charge schedule, and is required to initial for the surrender charge schedule options four times – once for the option the purchaser chooses, and once each for the three declined. This ensures that every purchaser is fully aware of the surrender charge. Fourth, each purchaser must also initial for the liquidity, or Penalty-Free Withdrawal Option, that they choose, ensuring that they are aware of that feature. Fifth, the fact that commissions are paid is prominently disclosed (in bold). Finally, there are a number of other disclosures regarding matters such as the Index crediting parameters, the interest adjustment, the death benefit, the annuitization benefit, the IRS tax penalty for early withdrawals, and use with qualified plans.

c. *Customer Satisfaction Survey Programs*

Midland utilizes two different customer satisfaction survey programs to help monitor for suitability and high standards of fair and sound sales practices. One of these is external, conducted by an independent third party, and the other internal, conducted by Midland.

<u>LIMRA Customer Assurance Program (CAP)</u>. The LIMRA CAP is an external post-purchase customizable survey program that is used to verify that annuity purchasers understand what they have purchased. The survey asks about surrender charges and tax penalties for early withdrawals, their understanding of and reliance on certain features, and the source of funds for the purchase. The LIMRA CAP also allows Midland to:

- Have an additional check to further monitor suitability;
- Proactively monitor the sales practices of our agents;
- Receive data analysis that reports potential problems; and
- Judge compliance and customer satisfaction performance against industry benchmarks.

This survey is sent to 100% of all new annuity policy owners. Follow up contact is made by Midland to any purchasers who provide inconsistent or imprecise responses to any of the survey questions. All discrepancies are resolved to the customer's satisfaction, up to and including cancellation of the annuity contract where appropriate.

<u>Midland's Policy Owner Satisfaction Survey Program</u> is an internal post-purchase survey program designed to provide further assurance that purchasers understand certain features and benefits of their fixed indexed annuity contract. Direct questions are asked to verify whether the purchase was a replacement (*i.e.*, bought with funds surrendered out of another annuity), the

owner's financial objective for the purchase, his or her income and net worth, the owner's overall financial liquidity, and understanding of the surrender charge. Surveys are conducted via outbound telephone calls on recorded lines.

As discussed above (see *Suitability* section), the goal is to contact 100% of fixed indexed annuity purchasers age 65 or older when they made their purchase. All survey responses are captured, tracked, and reported through a database. As with the LIMRA CAP, any issues or concerns identified through the review are resolved to the purchaser's satisfaction, up to and including cancellation of the annuity contract where appropriate.

d. *Agent Training*

All Midland agents are required to complete training and an agent certification program prior to being appointed (appointment by the issuing insurance company is a legal requirement to sell insurance products). This program entails an on-line or live meeting product education and training session regarding not only the annuity products themselves, but also company compliance and other policies and procedures, specifically including suitability issues. After the training, prospective agents are required to successfully complete a certification test. Thereafter, our field agents are required to re-certify their training every two years to ensure an understanding of new policies, procedures, and products. The re-certification involves successful completion of an on-line re-certification test.[23] This is required for all of our annuity products.

In order to sell our fixed indexed annuities, an agent must complete our full certification program, which includes a large focus specifically on fixed indexed annuities (there is a special agent certification test for indexed annuities). Conversely, an agent who is only going to sell traditional (non-indexed) fixed annuities has to complete an abbreviated certification program, which does not include any portion on indexed annuities.

This training specifically focusing not only on fixed annuities in general but fixed indexed annuities in particular, is clearly much more appropriate for insurance agents who are going to sell fixed indexed annuities than the training and education that would be required under FINRA rules if fixed indexed annuities were classified as securities. Training for a general securities license (FINRA Series 7) or even for a limited variable annuity and mutual fund license (FINRA Series 6) is largely irrelevant for agents selling fixed indexed annuities, and does not include any training or education regarding fixed indexed annuities. Midland's agents already get training and education that is appropriate for selling fixed indexed annuities. Requiring additional training in irrelevant subjects does not make sense.

e. *IMSA Membership*

Midland is a member of the Insurance Marketplace Standards Association ("IMSA"). IMSA is a voluntary, nonprofit, independent organization created by the life insurance industry

---

[23] We also conduct several in-person training sessions in major cities throughout the year, and strongly encourage attendance by all our agents at these sessions.

to strengthen consumer confidence and trust in the marketplace for individually sold annuities (as well as life insurance and long-term care insurance). IMSA-qualified companies commit to maintaining high ethical standards and to being fair, honest, and open in the way they advertise, sell and service their products.

The IMSA qualification process is premised upon IMSA's Principles of Ethical Market Conduct:

Principle 1: To conduct business according to high standards of honesty and fairness and to render that service to its customers which, in the same circumstances, it would apply to or demand for itself.

Principle 2: To provide competent and customer-focused sales and service.

Principle 3: To engage in active and fair competition.

Principle 4: To provide advertising and sales materials that are clear as to purpose and honest and fair as to content.

Principle 5: To provide for fair and expeditious handling of customer complaints and disputes.

Principle 6: To maintain a system of supervision and monitoring that is reasonably designed to demonstrate the company's commitment to and compliance with IMSA's Principles and Code of Ethical Market Conduct.

Every principle has accompanying Code provisions. To become IMSA qualified, a company must demonstrate compliance with each of IMSA's Principles and Code provisions.[24]

B. Allegedly Widespread Consumer Complaints and Excessive Sales Practices

The Release notes growing sales of fixed indexed annuities, and states that this growth has been accompanied by growth in complaints of abusive sales practices. However, the Release does not provide any support for this assertion. In fact, NAIC data reflect that fewer "closed confirmed" complaints have been made regarding fixed indexed annuities than either variable annuities or fixed-rate annuities.

C. Customers Purchase Fixed Indexed Annuities For Safety and Security

The Release makes clearly erroneous statements about why people purchase fixed indexed annuities. The Release claims that purchasers buy fixed indexed annuities for "the prospect of investment growth" and "market-related gains" and for the same reasons that individuals purchase mutual funds and variable annuities.[25] The release offers no support for these claims. The Release also claims that persons who purchase fixed indexed annuities are "vitally interested in the investment experience,"[26] again with no support.

---

[24] For more information on IMSA, go to www.imsaethics.org.

[25] Release, *supra* note 1, at 5.

[26] *Id.* at 27.

In fact, the opposite is more generally true. Persons purchase fixed indexed annuities because they do not want to take on investment risk. The key feature of fixed indexed annuities – like other fixed annuities – is the guarantee against investment loss. Amounts invested in fixed indexed annuities are not subject to market risk. Contrary to the claims in the Release, this is a key and fundamental difference between fixed indexed annuities, on the one hand, and mutual funds and variable annuities, on the other hand, where principal is very much exposed to market risk and investment loss.

The features of fixed indexed annuities themselves show that the Release's claims in this regard are incorrect. Investments in mutual funds and variable annuities participate fully in the market, and investors in those products realize the full amount of any market gains and losses in the underlying investments (subject of course to certain charges that are not market-related). However, purchasers of fixed indexed annuities do not participate fully in any gains in the applicable index and do not suffer any loss if the index declines. Depending on the product design, gains may be limited by an index "cap" that limits annual increases in the annuity value to a certain percentage, even if the growth in the index is higher; gains may be limited by a "participation rate" that limits indexed interest to a percentage (*e.g.*, 75%) of the growth in the index; indexed interest may be limited by a "spread" taken off the growth in the index; some products may have a combination of these limits. By purchasing a product with these limitations, the purchaser is accepting limitations and agreeing that they will not participate fully in any growth of the index, in return for the protection against downside risk. If the purchaser was really 'vitally interested' in realizing a market rate of return, as the Release claims, they would instead invest in mutual funds or variable annuities, which do not have explicit limits based on caps, participation rates, or spreads.

Accordingly, the Release's premise that purchasers buy fixed indexed annuities for the same reasons that they buy mutual funds or variable annuities is fundamentally flawed.

III. The Release's Rationale and the Proposed Test Are In Fundamental Conflict With and Clearly Not Supported by Supreme Court and Other Judicial Precedent. Proposed Rule 151A is Contrary to the Securities Act of 1933 and is Arbitrary and Capricious

A. Section 3(a)(8)

Section 3(a)(8) exempts from the registration provisions of the 1933 Act any annuity contract (or optional annuity contract) issued by an insurance company subject to the supervision of a state insurance commissioner (or similar entity or official). As noted above, in determining whether a particular insurance product is exempt under Section 3(a)(8), courts and the Commission have historically focused on three key factors in relation to the product: (1) the allocation of investment risk between the insurer and the contract owner; (2) the manner in which the product is marketed, *i.e.*, whether the product is being promoted primarily as insurance or primarily as an investment; and (3) whether the insurer assumes a meaningful mortality risk.

Two seminal Supreme Court cases, discussed below, laid the groundwork for the Section 3(a)(8) analysis that has been applied by the courts and the Commission for the past fifty years.[27] However, in proposing Rule 151A, the Commission has completely disregarded this well-established body of law and has instead, in effect, proposed a Rule that would result in a complete re-write of Section 3(a)(8), which it does not have the authority to do.

B. SEC v. VALIC

In S.E.C. v. Variable Annuity Life Insurance Co. of America ("VALIC"),[28] the United States Supreme Court held that the annuity contract at issue, a variable annuity, was not an "annuity" within the meaning of Section 3(a)(8) because the entire investment risk was borne by the annuitant, not the insurance company. Premiums collected under the VALIC contract were invested in common stocks and other equities, while benefits payable under the VALIC contract varied with the success of the company's equity investments -- an interest which the Court characterized as having "a ceiling but no floor."[29]

The Court noted that "insurance" typically involves the company's guarantee that at least some fraction of the benefits will be payable in fixed amounts. The Court concluded that absent some guarantee of fixed income, an annuity places all investment risks on the annuitant, not the insurance company, thus failing the test of "insurance."[30] The Court observed that the VALIC contract guaranteed the annuitant only "a pro rata share of what the portfolio of equity interests reflects -- which may be a lot, a little, or nothing. There is no true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding and usage."[31]

C. SEC v. United Benefit

In an attempt to provide the investment risk assumption that the Supreme Court found lacking in VALIC, the insurance company in S.E.C. v. United Benefit Life Insurance Co. ("United Benefit")[32] guaranteed that the value of a deferred (essentially variable) annuity contract after ten years would never be less than the aggregate net premiums paid under the contract. United Benefit's contract was a deferred or optional annuity plan, with a "pay-in" period during which the annuitant's net premiums were placed in a separate account, composed primarily of common stocks. The value of the net premiums varied according to the investment experience of the separate account. At maturity, the purchaser could either convert the value of his or her interest to a fixed-payment life annuity or elect to receive in cash the greater of (a) his or her interest in the separate account or (b) aggregate net premiums.

---

[27] *See* cases cited in note 11, *supra.*

[28] *Supra* note 9.

[29] *Id*. at 72.

[30] *Id*. at 71.

[31] *Id*. at 71, 73 (footnote omitted).

[32] *Supra* note 11.

After determining that the variable "pay-in" and fixed "pay-out" phases of the annuity at issue must be analyzed separately, the Supreme Court concluded that the variable "pay-in" phase did not qualify for the Section 3(a)(8) exemption. The Court noted that during the "pay-in" period, "[i]nstead of promising to the policyholder an accumulation to a fixed amount of savings at interest, the insurer promise[d] to serve as an investment agency and allow the policyholder to share in its investment experience."[33] United Benefit merely promised to return at the end of a 10-year holding period, at a minimum, net premiums paid, an "amount [that] is substantially less than that guaranteed by the same premiums in a conventional deferred annuity contract."[34] The Court found that while this guarantee "reduce[d] substantially the [contract holder's] investment risk," "the assumption of an investment risk cannot by itself create an insurance provision."[35] Importantly, the Court's holding that the "pay-in" portion did not come within Section 3(a)(8) was also influenced by the fact that operation of the annuity required modifications of state insurance law and that the annuity's appeal to purchasers was its prospect of "growth" through sound investment management rather than "the usual insurance basis of stability and security."[36] Moreover, unlike the annuity in United Benefit, fixed indexed annuities offer the ability to withdraw a significant amount of the initial premium without any risk of loss whatsoever over a relatively short period of time by way of 10% penalty-free annual withdrawals.

D. Malone v. Addison

While it is unnecessary for purposes of this letter to further analyze each of the court decisions following VALIC and United Benefit, the most recent decision, Malone v. Addison Ins. Mktg., Inc. ("Malone"),[37] is noteworthy in that the district court held that the fixed *indexed* annuity contract at issue was entitled to rely on the Section 3(a)(8) exemption. In Malone, the issue presented to the court was whether an indexed annuity, which provided that the insurer guarantee that the investor received 100% return of premium plus at least 3% interest annually was a security under the 1933 Act. The court framed its inquiry as a "proportionality" test that required it to determine whether the contract "operates more like a variable or a fixed annuity."

The court reviewed the relevant case law, focusing its inquiry on the division of the investment risk between the insurer and the insured. The court found that the insurer assumed significant investment risk because it was obligated to return premium plus 3% annual interest regardless of how poorly the market performed. The only investment uncertainty assumed by the investor, according to the court, was whether she would receive excess interest *beyond* 3% per year on her premium payment. The court noted further that there was no direct correlation between the benefit payments and the performance of the investments made with the contract owner's premium. The court concluded the proportionality test under Section 3(a)(8) had been

---

[33] *Id*. at 208.

[34] *Id*. The annuity guaranteed that the first year cash value of the annuity would never be less than 50% of net premiums paid and that, after ten years, the value would be no less than 100% of aggregate net premiums paid under the contract.

[35] *Id*. at 211 (emphasis added).

[36] *Id*.

[37] *Supra*, note 11.

met: "Because the Defendants assume a much greater risk, Plaintiff's investment seems a lot more like insurance and less like an investment."[38]

The Commission briefly discussed the holding of the Malone court in footnote 38 to the Release, after setting forth its position that indexed annuities, which credit indexed interest retroactively, may not rely on the safe harbor provided by Rule 151 of the 1933 Act because they do not meet its fourth investment risk condition. The Commission noted that the Malone court held that the indexed contracts at issue satisfied Rule 151, but that the court did not appear to take into account the retroactive nature of the indexed interest crediting. For this reason, the Commission appears to have completely disregarded the Malone holding. However, the Malone court only turned to its Rule 151 analysis *after* determining that the indexed annuities were exempt from the federal securities laws under Section 3(a)(8).[39] In fact, the court devoted much of its analysis to the Section 3(a)(8) judicial precedent, and determined that because the indexed annuities were more like fixed annuities than variable annuities, they were "excluded from the definition of 'security' under the Supreme Court's opinions in VALIC and United Benefit."[40] The Commission's abrupt dismissal of the Malone decision overlooks an important judicial determination that indexed annuities fall within the purview of Section 3(a)(8).

E. Section 3(a)(8) Analysis Requires Entire Facts and Circumstances Test

The Proposed Rule, and, in particular, its singular focus on a "more likely than not" test, is inconsistent with the judicial history of Section 3(a)(8), where courts have focused not only on the allocation of investment risk, but also on the assumption of mortality risk and the marketing of the product. While the "more likely than not test" does focus on the assumption of upside "risk" by a fixed indexed annuity owner, it does not properly take into account the *allocation* of risks, including downside risks, between the owner and the insurer. Instead, under this test, if *any* upside investment risk is borne by the owner because the amounts payable under a contract are more likely than not to exceed the amounts guaranteed, the contract is deemed to fall outside of the Section 3(a)(8) exemption. Moreover, the Proposed Rule completely ignores any mortality risk assumed by the insurer and the manner in which a contract is marketed.

Simply put, the Proposed Rule does not take into account all of the relevant facts and circumstances that must be considered when analyzing a product's status under the Section 3(a)(8) exemption, which is contrary to the Commission's own prior pronouncements as well as the entire Section 3(a)(8) judicial record.[41] The Commission cannot, by rule or otherwise, pick

---

[38] *Id*. at 751, citing VALIC at 71.

[39] *Id*. at 751. After its Section 3(a)(8) determination, the court stated that it "could end its inquiry here. However, [Rule 151] also merits discussion because it guarantees certain types of annuities an exemption from federal securities law." *Id*.

[40] *Id*.

[41] *See, e.g.*, Definition of Annuity Contract or Optional Annuity Contract, Securities Act Release No. 6645, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,004 (May 29, 1986) ("Release 6645") at 88,130 ("[t]he presence or absence of a mortality risk assumption may be an appropriate factor to consider in a general facts and circumstances analysis under section 3(a)(8)") (emphasis added); *see also* General Statement of Policy Regarding Exemptive Provisions Relating to Annuity and Insurance Contracts, Securities Act Release No. 6051, 1 Fed. Sec. L.

and choose which factors it deems to be important to a Section 3(a)(8) analysis, and thereby exclude from Section 3(a)(8) annuity contracts that could well be within judicial interpretations of the exemption enacted by Congress.

1. The Allocation of Investment Risk

a. *Investment Risk Borne by an Issuer Must be Considered in any Section 3(a)(8) Analysis.*

Section 3(a)(8) jurisprudence does not permit a determination of the status of a product under the federal securities laws to be made based solely on a single component of investment risk. Rather, the allocation of such risk between the contract owner and the issuer must be considered. In VALIC and United Benefit, the insurance companies took virtually no investment risk. The analysis in the Release focuses almost entirely on the purported risk borne by the purchaser, and largely overlooks or discounts the investment risk borne by the insurer. As a result, the test in the second prong (paragraph (a)(2)) of Proposed Rule 151A focuses only on one factor – the likelihood of receiving excess interest (*i.e.*, interest in excess of any guaranteed amounts). However, VALIC and United Benefit clearly require that the investment risk borne by the company be taken into account – indeed, it is a key factor in the Supreme Court's interpretation of Section 3(a)(8) that the Commission is not at liberty to ignore.[42]

The VALIC court stated that "the concept of 'insurance' involves some investment risk-taking on the part of the company" (emphasis added),[43] that "the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense" (emphasis added),[44] and that with the variable annuity, there "is no true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding and usage" (emphasis added).[45] The VALIC court's decision was based on the fundamental fact that a variable annuity places all of the investment risk on the purchaser, and none on the insurance company. The Court's analysis, and these statements, clearly mean that the company's assumption of risk is not only a relevant factor, but a key factor in any section 3(a)(8) analysis.[46] Proposed Rule 151A is fundamentally inconsistent with the Supreme Court's interpretation of a Congressionally enacted statute, since the proposed rule focuses solely on the likelihood of any indexed interest (no matter how small in amount) being included in amounts payable and ignores the investment risk borne by the company.

Rep. (CCH) ¶ 2111 (Apr. 5, 1979) at 2580 ("[i]n many instances, the determination of whether [mortality and investment] risks are assumed will depend upon the total facts and circumstances connected with the offer and sale of a contract . . .") (emphasis added).

[42] It is, of course, also a key factor in how other federal courts have interpreted and applied Section 3(a)(8). *See* cases cited in note 11, *supra.*

[43] VALIC at 71.

[44] *Id.*

[45] *Id.* at 73.

[46] United Benefit followed the Court's reasoning in VALIC.

As noted in the United States' *amicus curiae* brief in Otto v. Variable Annuity Life Insurance Co.[47] (presented with significant assistance from the Commission – the Commission's General Counsel and four other Commission officials are named on the brief), "it is clear that the assumption of a substantial 'investment risk' by the insurance company is [a] crucial factor" in any Section 3(a)(8) analysis.[48] That brief, stating the position of the United States and obviously reflecting the Commission's view, also stated:

> The relevant purpose of the securities laws is to ensure that investor in securities are fully and accurately informed about the issuer and the investment's relevant features, including its risks. *This protection is not needed if, inter alia, the insurance company assumes a sufficient share of investment risk, which reduces the risk to the participant, who is also protected by state regulation.*[49]

The Seventh Circuit, in *Otto v. VALIC*, succinctly summed this up by stating as follows:

> [T]he Supreme Court, this circuit and the Securities and Exchange Commission (the "SEC") all have found that *the degree of investment risk assumed by the insurance company is an important factor* in determining whether a particular annuity plan is an insurance product or a security.[50]

The Proposed Rule, however, focuses solely on whether *any* indexed interest may be paid to the owner, even if such amounts may be minuscule, and not on the amount of indexed interest to be paid relative to the principal and interest guarantees provided by the issuer (*i.e.*, the comparison of the investment risk assumed by the owner against that borne by the issuer). By ignoring this risk, the Proposed Rule is inconsistent with the Supreme Court's interpretation of Section 3(a)(8), as discussed in the VALIC and United Benefit cases, and inconsistent with what the Commission told the Supreme Court (in the Otto brief) is the correct interpretation of Section 3(a)(8). Those cases, and the case law that developed subsequent thereto, clearly stated that an insurer's assumption of investment risk is a key factor when determining the status of a contract under Section 3(a)(8). As noted above, in both VALIC and United Benefit, the insurance companies assumed virtually no investment risk with respect to the variable annuities at hand, which resulted in the court's determination that, in each case, the annuities were securities.[51]

---

[47] 814 F.2d 1127 (7th Cir. 1986), rev'd on rehearing, 814 F.2d 1140 (1987), modified (1987), cert. denied, 486 U.S. 1026 (1988) (supporting the petition for a writ of certiorari).

[48] *Id*. at 6.

[49] *Id.* at 7 (emphasis added).

[50] *Otto v. VALIC, supra* note 11, 814 F.2d at 1141 (emphasis added).

[51] *See, e.g.*, VALIC, *supra* note 9, at 71 (stating "[t]he difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. . . we conclude that the concept of "insurance" involves some investment risk-taking on the part of the company"). United Benefit followed the Court's reasoning in VALIC, noting that while the insurer did provide a minimum guarantee under the contract, the level of investment risk assumed by the insurer was "insignificant." *See* United Benefit, *supra* note 11, at 208.

This analytical framework continues throughout succeeding case law to the most recent judicial decision,[52] only to be ignored by the Commission in its proposal.

An insurer's assumption of investment risk must be considered, and to do so requires an analysis of the guarantees provided under the contract (*e.g.*, guarantees of principal and previously credited interest, minimum interest rate guarantees, penalty-free withdrawals, the obligation of the insurer not only to credit indexed interest based on the performance of the external index and in accordance with the formula set forth in the contract but to be bound by the contractual limits on features that operate to limit the amount of indexed interest to be credited, such as participation rates and growth caps). The stronger the guarantee, and the higher the number of guarantees provided, the greater the shifting of investment risk from the owner to the insurer. Nevertheless, the Proposed Rule would redefine virtually all fixed indexed annuities as securities regardless of the level of investment risk assumed by the insurer.[53]

By ignoring the investment risk borne by the insurer, however, the Proposed Rule contradicts such precedent, is arbitrary and capricious, and therefore should not be adopted.

b. *Rigorous State Insurance Requirements for Fixed Indexed Annuity Issuers Demonstrate the Assumption of Investment Risk by the Issuer.*

Insurance companies are subject to extensive state insurance regulation, including the requirement to maintain sufficient levels of capital, surplus, and risk-based capital, to ensure that the insurer will be able to meet its contractual obligations and maintain its credit ratings. When discussing investment risk in the Release, the Commission acknowledged the significant protections provided by state insurance regulation and cited Justice Brennan's concurring opinion in VALIC, which noted that any Section 3(a)(8) determination would need to take into account whether Congress intended for the annuity at hand to be regulated exclusively by state insurance commissioners.[54] The Commission indicated that the federal securities laws should govern when state insurance laws pertaining to insurer solvency and the adequacy of an insurer's reserves are insufficient in protecting an investor's investment in an annuity.[55]

Insurers issuing fixed indexed annuities are required to maintain high levels of capital and surplus because they assume most, if not all, of the investment risk under the contract. In contrast, an insurer's capital and reserve obligations for its variable annuity business are much lower, because state insurance regulators recognize that while insurance companies bear most of the investment risk under a fixed indexed annuity, they bear virtually none under a variable annuity. Indeed, although the actual level of risk based capital varies among different products

---

[52] *See* Malone, *supra* note 11, at 750 (finding that due to a 3% minimum interest rate guarantee, the insurer, and not the owner, assumed the investment risk under the contract).

[53] The Commission assumes that all fixed indexed annuities that are issued after the effective date of the Proposed Rule will be registered. Release, *supra* note 1, at 64.

[54] Release, *supra* note 1, at 19.

[55] *Id*.

and companies, the level of capital held by Midland for assets in the variable annuity separate account may be only 4% of that required to back the same amount of assets in a fixed indexed annuity. This is because a variable annuity owner's risk that he will receive less than his investment in the contract is dependent on the performance of his or her cash value in the separate account, whereas a fixed indexed annuity owner's risk that he will receive less than his investment in the contract is dependent on the insurer's solvency (*i.e.*, whether the insurer can meet its contractual obligations). The critical distinction is that the former is an assumption of investment risk borne by the variable annuity owner, while the latter is not. Rather, it is the insurance company who bears the risk of investment loss under a fixed indexed annuity. This is evident from the fact that the insurance company is mandated by state law to maintain sufficient capital and reserves to satisfy its contractual obligations in the event it experiences an investment loss due to the performance of the assets in its general account.

c. *Unlike Issuers of Variable Annuities and Mutual Funds, Fixed Indexed Annuity Issuers Assume Meaningful Investment Risk By Providing Significant Guarantees Under the Contract.*

The Commission sets forth its view in the Release that fixed indexed annuities are "similar in many ways" to other securities, such as variable annuities and mutual funds, and notes that purchasers are "vitally interested in the investment experience" that such contracts offer through "participation in the securities markets."[56] The Commission explained that "many of the same risks" assumed by an investor in a variable annuity or mutual fund are assumed by a fixed indexed annuity purchaser.[57] Simply put, equating a fixed indexed annuity contract's "risk" with the investment risk assumed under a variable annuity or mutual fund is a fundamentally flawed analysis. The purchase of a fixed indexed annuity does not entail an investment in a market index, nor does it involve the level of investment risk that one would assume if making such an investment. Rather, because of the insurance protection afforded by state nonforfeiture guarantees of principal and interest, there is only a fraction of the risk that would be assumed by a direct investment in the market. In contrast to the variable annuities in VALIC, fixed indexed annuities have a very substantial "element of a fixed return."[58]

As noted by the Malone court, fixed indexed annuities are distinct from, and fundamentally different than, the variable annuities at issue in VALIC and United Benefit. In particular, the purchaser of a variable annuity assumes virtually the entire investment risk under the contract, namely, the risk – as identified in VALIC and United Benefit - of a significant loss of principal due to poor investment performance. In contrast, fixed indexed annuities do not credit negative indexed interest and do guarantee a very substantial portion of principal and previously credited interest, and any decreases in contract value are unrelated to any negative performance of the external index. These guarantees shift a significant portion of the contract's investment risk from the owner to the insurer, unlike the variable annuities at issue in VALIC,

---

[56] *Id.*, at 27.

[57] *Id.* at 6, 32.

[58] VALIC, *supra* note 9, at 71.

which placed "all the investment risks on the annuitant, [and] none on the company."[59] And while fixed indexed annuity purchasers may receive varying amounts of indexed interest, or, in some cases, no indexed interest during certain periods, this is no more an assumption of investment risk than that assumed by purchasers of traditional fixed annuities, who also experience fluctuations in the amount of excess interest they may receive. Moreover, the amount of interest that a fixed indexed annuity purchaser will receive depends not on the investment experience of the insurer, but rather on the guarantees provided by the insurer and the return of an unmanaged external index.[60]

Nevertheless, the Commission has dismissed such guarantees, noting that variable annuities also "typically provide some protection against the risk of loss," and that "[t]he presence of protection against loss does not, in itself, transform a security into an insurance or annuity contract."[61] What the Commission has failed to address, however, is the *level* of investment risk assumed, and the *degree* of protection provided, by the issuer under fixed indexed annuities as compared to variable annuities (or mutual funds). The Commission has instead focused solely on a fixed indexed annuity owner's potential to receive excess interest above any contractual guaranteed amounts. Articulating a test that that looks solely at the upside investment risk associated with indexed interest, however, is in direct conflict and fundamentally inconsistent with the Commission's views in the Otto *amicus curiae* brief, where it essentially took the position that the ability of an insurer to change the excess interest rate at its sole discretion without restriction as to frequency did not by itself take a contract out of Section 3(a)(8).[62]

In sum, the Proposed Rule's "more likely than not" test indicates that a fixed indexed annuity purchaser's uncertainty with regard to the likelihood that he or she will receive indexed interest is itself enough for the annuity to fail to qualify for the Section 3(a)(8) exemption. In other words, if a contract does not fall within Rule 151's safe harbor, the contract is essentially the same as a variable annuity, mutual fund, or other security and does not meet the Section 3(a)(8) exemption. This leap of logic is simply incorrect. The Commission made clear in the Otto *amicus curiae* brief that the Otto court was "mistaken" if it concluded that the annuity at issue did not fall within the Section 3(a)(8) exemption solely because it did not guarantee excess

---

[59] *Id*.

[60] In contrast, where the investor shares in the investment experience of the insurance company itself, the contract is not one that Congress intended to be regulated exclusively by state insurance commissioners. VALIC, *supra* note 9, at 78 (concurring opinion by Justice Brennan). *See, e.g.*, United Benefit, *supra* note 11, at 208 (holding that the annuity was a security because "the insurer promises to serve as an investment agency and allow the policyholder to share in its investment experience"); *see also* Report of the Division of Investment Management of the Securities and Exchange Commission Regarding the Securities Act Status of Guaranteed Investment Contracts and the Investment Company Act Status of Issuers of Such Contracts 3 (Jan. 20, 1987) (noting, in a discussion of the VALIC case, that "[u]nder a variable annuity contract, a contract owner's purchase payments are invested in a pool of securities and benefits under the contract that vary directly with the pool's investment performance. In the purest form of variable annuities, the insurer does not guarantee any level of benefits and does not assume any investment risk").

[61] Release, *supra*, note 1 at 27 n. 52.

[62] Brief for the United States as Amicus Curiae, *supra*, note 47, at 8.

interest for one year. Rather, the Commission noted in the brief that Rule 151 is simply a safe harbor that does not attempt to identify the outer limits of the exemption, and whether a contract meets the exemption should be determined with reference to VALIC and United Benefit.[63] The Commission, however, did not attempt in the Release to distinguish fixed indexed annuities from the specific contracts in VALIC and United Benefit, nor from variable annuities or mutual funds in general, and therefore has drafted a Proposed Rule that is in fundamental conflict with, and clearly not supported by, the Supreme Court and other judicial precedent.

It is important to note that the Commission, in its Otto *amicus curiae* brief, essentially took the position that the ability to change excess interest rates more frequently than annually does not, in itself, disqualify an annuity from the Section 3(a)(8) exclusion. The "risk" of frequent changes in excess interest focuses solely on the "risk" involved in the upside potential of excess interest. The "more likely than not" test in Proposed Rule 151A also focuses solely on the upside potential "risk" involved with the crediting of excess interest - of it being more likely than not that excess interest will be paid.[64] Proposed Rule 151A is fundamentally inconsistent with what the Commission itself told the Supreme Court is the correct interpretation of the investment risk element of Section 3(a)(8).

d. *Any Loss of Principal Resulting From a Fixed Indexed Annuity's Charges Does Not Shift Investment Risk to the Owner.*

Almost no fixed indexed annuities permit the crediting of "negative" indexed interest under the contract; a built in minimum indexed interest rate of 0% (or even higher) is guaranteed regardless of the performance of the external index, thus ensuring that indexed interest will never invade principal or previously credited interest. Moreover, while participation rates, growth caps, or similar types of features may limit the amount of indexed interest to be credited, these features also do not invade principal or previously credited interest.

In fact, the only contract features that could result in a purchaser receiving less than his full premium in a fixed indexed annuity would be the contract charges, such as a surrender charge or interest adjustment (and perhaps state premium taxes). However, any loss of principal or previously credited interest due to the imposition of a surrender charge or interest adjustment can only occur if the fixed indexed annuity owner voluntarily decides to prematurely withdraw from or surrender the contract (and any such loss is limited by the guarantee of the contract). This risk is no different than that assumed under a traditional declared rate annuity, and is in significant contrast to the risk assumed by a variable annuity or mutual fund owner, who may lose principal simply by being a passive investor in the market.

Moreover, a surrender charge or partial withdrawal charge does not operate to shift investment risk to an owner even if there is a loss of principal and/or previously credited interest as a result of the charge. Pursuant to the safe harbor under Section 3(a)(8) provided by Rule 151, an insurer is only required to guarantee, for the life of the contract, the principal amount of the

---

[63] *Id*. at 6.

[64] In Proposed Rule 151A, the difference between the amount payable and the amount guaranteed is the amount of excess interest.

premium and interest credited thereto, net of deductions for sales, administrative, and other expenses. Moreover, the maximum guaranteed charges typically are set at the time the contract is issued and are contingent solely on whether and when a surrender or partial withdrawal occurs. Accordingly, annuity contracts can qualify for the Rule 151 safe harbor even if a surrender charge would "invade principal." In adopting Rule 151, the Commission itself recognized that surrender charges do not shift additional investment risk to a fixed annuity owner.[65] And the Seventh Circuit has explicitly stated that sales loads and other charges in fixed annuities "did nothing to throw *investment* risk on the investor" (emphasis in original).[66]

2. The Assumption of Mortality Risk

While the assumption of mortality risk by the insurer is not sufficient, by itself, to qualify for the Section 3(a)(8) exemption,[67] an analysis of this risk, pursuant to judicial interpretations, may be relevant in determining whether an annuity contract falls within Section 3(a)(8).[68] Prior to the Proposed Rule, the Commission also appeared to be of the view that mortality risk may be an appropriate factor to consider in making a Section 3(a)(8) determination. As the Commission clarified in its adopting release to Rule 151, the decision not to include a mortality risk assumption requirement in the rule did not mean that an analysis of such risk "has no place in a [S]ection 3(a)(8) analysis of annuity contracts outside the 'safe harbor.'"[69] The Otto *amicus curiae* brief reiterated the Commission's view on mortality risk.[70]

By failing to take into account *any* mortality risk assumption under the Proposed Rule (in fact, the Commission makes no mention of mortality risk anywhere in the Release), the Proposed Rule may operate to define certain contracts as securities even though the assumption of mortality risk could persuade a court otherwise under a Section 3(a)(8) determination,

---

[65] *See* Release 6645, *supra*, note 41, at 88,132 n.20 (stating that "a contingent deferred sales load ("CDSL") is simply a sales load that is deducted upon partial or full redemption and that is contingent on the number of years the contract has been in effect. A CDSL normally does not shift additional investment risk to the contractowner . . .").

[66] *See Associates in Adolescent Psychiatry, supra* note 11, 941 F.2d at 567.

[67] *See, e.g.*, VALIC, *supra* note 9, at 71.

[68] *Id*. (noting that the insurer's assumption of mortality risk under an annuity contract "gives [the annuity] an aspect of insurance"); *see also id*. at 81 n.19 (Justice Brennan, concurring) (stating that an annuity contract that lacked any "mortality" factor would appear to be wholly without an insurance element); Grainger v. State Security Life Insurance Co., 547 F.2d 303, 306, reh'g denied, 563 F.2d 215 (5th Cir. 1977), cert. denied sub nom. Nimmo v. Grainger, 436 U.S. 932 (1978) (finding that in a Section 3(a)(8) analysis, it is proper to consider that a life insurance contract provides a significant fixed death benefit); Dryden v. Sun Life Assurance Co. of Canada, *supra*, note 11, at 1062 (concluding, without performing a full analysis under Section 3(a)(8) or Rule 151, that the insurer's obligation to pay the fixed sum caused it to bear the risk of poor performance of its investments, and consequently, there was a true underwriting of risks by the insurer, as discussed in VALIC).

[69] Release 6645, *supra*, note 41, at 88,130 (noting that "[t]he presence or absence of a mortality risk assumption may be an appropriate factor to consider in a general facts and circumstances analysis under [S]ection 3(a)(8)").

[70] Brief for the United States as Amicus Curiae, *supra* note 47**,** at 9-10 (stating that "another factor in a Section 3(a)(8) analysis is whether the insurance company assumes a meaningful mortality or longevity risk. . . . if [an insurer's] marketing tactics place the status of its fixed-annuity contract in doubt, [the insurer's] assumption of a meaningful mortality risk might nonetheless tip the balance in favor of a conclusion that the contract is an 'annuity contract' under Section 3(a)(8)").

particularly where the court is ambivalent with respect to the contact's marketing and allocation of investment risk.

3. The Manner in Which a Product is Marketed

In virtually every case decided since VALIC, courts have viewed marketing as a significant, and in some instances, determinative, factor in deciding whether an insurance contract is a security.[71] The Commission, as well, has emphasized its belief that "the manner in which a contract is *primarily* marketed is a significant factor which must be considered in determining a contract's status under the federal securities laws."[72] The Proposed Rule, however, fails to consider the manner in which an annuity contract is marketed, even though the Commission acknowledged in the Release that marketing is "another significant factor" in a Section 3(a)(8) determination.[73] Moreover, the Commission devoted several pages of the Release to a discussion of the marketing of fixed indexed annuities,[74] but did not once acknowledge that the Malone court, when analyzing fixed indexed annuities under Rule 151, found that the contracts were not marketed as investments.[75]

As is the case with disregarding an insurer's assumption of investment risk and mortality risk, the Commission's failure to consider the marketing of an annuity contract completely ignores judicial precedent and, consequently, creates a situation where contracts that might otherwise be determined to fall within the Section 3(a)(8) exemption due to the marketing of such contracts primarily on the basis of stability and security rather than the prospect of growth will instead be swept into the Proposed Rule's "perilous harbor."

IV. The Proposed Rule is Unworkable

A. The Proposed Rule is Overly Broad

As previously noted, the Proposed Rule's test as to whether an annuity is not an "annuity contract" under Section 3(a)(8) is comprised of two components. The first of these two elements calls into question the securities status of contracts where "[a]mounts payable by the issuer . . . are calculated, in whole or in part, by reference to the performance of a security, including a group or index of securities." If this prong is met, a contract further meeting the second component, whereby "[a]mounts payable by the issuer under the contract are more likely than

---

[71] *See, e.g.*, United Benefit, *supra* note 11.

[72] Release 6645, *supra* note 41, at 88,137 (citing to United Benefit as well as to similar prior Commission positions articulated in Securities Act Release No. 6051, 1 Fed. Sec. L. Rep. (CCH) ¶ 2111 (Apr. 5, 1979) and Securities Act Release No. 6050 (April 5, 1979) [44 FR 21656 (April 11, 1979)]).

[73] Release, *supra* note 1, at 19.

[74] *Id*. at 14-17.

[75] Malone, *supra* note 11, at 753 (distinguishing between United Benefit, where reliance on the possibility of investment return was viewed as evidence of an "appeal to the purchaser. . . on the prospect of 'growth' through sound investment management," and Otto, where the annuity was found to have been "marketed primarily on the basis of its stability and security").

not to exceed the amounts guaranteed under the contract," would be disqualified from relying on the Section 3(a)(8) exemption.

The scope of the first component of the Proposed Rule's test is far-reaching and raises questions regarding the securities status of all fixed annuities, including even those that fall within the Section 3(a)(8) safe harbor provided by Rule 151. While the Commission itself stated in the Release that the Proposed Rule is meant to "define the class of contracts that is subject to scrutiny broadly,"[76] and clearly intends for the Proposed Rule to cover fixed indexed annuities,[77] it does not seem likely that the Commission also expects the Proposed Rule to encompass traditional fixed annuity products. Yet, it is difficult to identify many fixed annuity contracts that would not be caught within the test's broad parameters. By way of example, each of the following types of contracts would potentially fail the Proposed Rule's expansive test:

- virtually all discretionary excess interest contracts (because all insurers at least consider the securities investments in their general account when declaring excess interest rates);
- unregistered traditional fixed annuities with market value adjustments that are calculated by reference to U.S. Treasury or other securities;
- funding agreements and group annuities that calculate interest by taking into account the performance of securities; and
- traditional participating policies with dividend formulas that have an investment component.

Clearly most, if not all, of these types of contracts do not raise the concerns articulated by the Commission in the Release when explaining the supposed need for the Proposed Rule. In fact, many of these contracts fall within the Rule 151 safe harbor, and yet still may meet the Proposed Rule's test of what is not an annuity contract under Section 3(a)(8). For example, discretionary excess interest contracts that do not modify the excess rate of interest more frequently than annually are typically viewed as excluded from the 1933 Act, as are fixed indexed annuities that declare interest prospectively.[78] It is not clear how the Commission intends to reconcile the Proposed Rule with Rule 151, or explain how the test set forth under the Proposed Rule is feasible if it defined as "not an annuity" annuity contracts that fall within the Rule 151 safe harbor.

This inconsistency created by the Proposed Rule demonstrates why the proposal of a test that would serve to classify certain contracts as securities is simply unworkable. As previously noted, attempting to articulate what is and is not a security through the use of a simple definition

---

[76] Release, *supra* note 1, at 31.

[77] As previously noted, the Commission anticipates that all indexed annuities will be registered if the Proposed Rule is adopted. Release, *supra*, note 1, at 64.

[78] *See* Release 6645, *supra* note 41, at 88,136; *see also* SEC Concept Release, *supra* note 7, at 89,817 (noting the Commission's "decision to limit the benefit of Rule 151 to situations where an index is used to fix a specific excess interest rate in advance").

is inconsistent with long-standing judicial precedent that mandates that all of the facts and circumstances be considered in any Section 3(a)(8) analysis. It is one thing to provide a definition for contracts that fall within a safe harbor and thus meet the Section 3(a)(8) exemption, but quite another to attempt to conclusively define contracts that fall within a perilous harbor and thus do not qualify for the Section 3(a)(8) exemption.

Moreover, it is unclear where this leaves insurance companies that issue contracts that meet neither the conditions of Rule 151 nor the test set forth under Proposed Rule, as well as courts attempting to analyze such contracts under Section 3(a)(8). For example, if a contract does not meet the definition of <u>not</u> an "annuity contract" under the Proposed Rule, does that mean it <u>is</u> an "annuity contract" under Section 3(a)(8), thus rendering as unnecessary any further securities analysis of such contract?

In sum, the first prong of the Proposed Rule's test, which is overly broad and likely would result in the inclusion of most fixed annuity contracts in its definition of contracts that are "indexed," is not an appropriate test.[79]

B. The "More Likely Than Not" Test is Unworkable

The second element of the Proposed Rule's test when determining if an annuity is not an "annuity contract" under Section 3(a)(8) is whether "[a]mounts payable . . . are more likely than not to exceed the amounts guaranteed" under a contract. This test sets forth a new legal standard that has not previously been considered by insurance companies, that will be costly to undertake, and that, ultimately, will be unworkable to implement.

Foremost, it will be imperative that actuaries perform the analysis under the "more likely than not" test, as other insurance company personnel simply will not have the expertise to make the sophisticated and complex assumptions and assessments required thereunder. Among other things, the test requires an analysis of "expected outcomes under various scenarios involving different facts and circumstances;"[80] the consideration of certain facts and circumstances, including the contract's features; surrender, annuitization, or other options chosen by the purchaser; the performance of the external index;[81] the need to make assumptions about issues

---

[79] The broad scope of the Proposed Rule also may implicate the securities status of certain life insurance policies, including fixed indexed life insurance policies. The Commission expressly stated in the Proposing Release that the Proposed Rule does not apply to "life insurance, health insurance, or any form of insurance other than an annuity." Release, *supra*, note 1, at 28-29. Nonetheless, the Proposed Rule advances a new analytical framework that, if adopted, may implicate the status of a fixed indexed life insurance policy under Section 3(a)(8). If the Proposed Rule is adopted, the Commission must make clear that neither the Rule nor the legal principles on which the Rule is based are applicable to fixed indexed life insurance policies.

[80] Release, *supra* note 1, at 33.

[81] *Id*.

such as "insurer behavior, . . . purchaser behavior, and . . . market behavior;"[82] and the necessity to "assign probabilities to [such] behaviors."[83]

Contrary to the assumptions made by the Commission in the Release, insurance companies do not currently perform testing in the manner contemplated by the Commission with respect to their fixed indexed annuities.[84] As a result, most insurance companies will need to hire additional actuaries to help implement the various schematics that must be designed to fully meet the Commission's expectations of the analysis required by the test. Moreover, there is little guidance as to how the test should be implemented. The Release only provides very basic guidance as to the Commission's expectations of how to perform the test; in fact, the Commission itself acknowledges that there may be a "range of methodologies and assumptions" that an insurer could undertake.[85] Insurers also cannot look to the industry for guidance as no relevant Actuarial Standard of Practice currently exists. The American Academy of Actuaries (the "Academy") will need to adopt new standards to address the appropriate actuarial assumptions needed to implement the test. To our knowledge, the Commission did not consult the Academy prior to publishing the Release, and therefore the development of any such Actuarial Standard of Practice likely would take months (if not years) to development following the adoption of the Proposed Rule. And even if standards are eventually put into place, ongoing testing will nonetheless place heavy burdens on an actuary's (and, ultimately, an insurance company's) time and resources. These considerations further demonstrate that a 12-month implement deadline is insufficient. (*See* Section VII, below.)

Moreover, even with the development of an Actuarial Standard of Practice, the "more likely than not test" is ambiguous with respect to both initial and ongoing testing. First, different actuaries analyzing similar annuities could arrive at inconsistent conclusions as to the annuity's securities status as a result of applying different, but nonetheless reasonable, methodologies and assumptions. In addition, requiring that an annuity contract that falls outside the Proposed Rule be tested repeatedly to prove its continued exempt status raises issues if subsequent reasonable assumptions result in the reclassification of the annuity as a security. This could expose an insurance company to litigation from private plaintiffs who previously purchased the unregistered annuity and now challenge the reasonableness of the company's earlier assumptions.[86] This risk cannot be eliminated by revising the Proposed Rule so as to require

---

[82] *Id*. at. 37

[83] *Id*.

[84] *Id*. at 39 (noting that "insurers routinely analyze anticipated outcomes for purposes of pricing and hedging their contracts, and for similar purposes. We would expect that, in making a determination under proposed rule 151A, an insurer would use assumptions that are consistent with the assumptions that it uses for other purposes.")

[85] The Release makes clear that ". . . a range of methodologies and assumptions may be reasonable and . . . a reasonable methodology or assumption utilized by one insurer may differ from a reasonable assumption or methodology selected by another insurer." *Id*. at. 37.

[86] The Commission acknowledged in the Release that an insurer "bears the burden of proving that a [Section 3(a)(8)] exemption applies" and "would – if challenged in litigation – be required to provide that its methodology and its economic, actuarial, and other assumptions were reasonable, and that the computations were materially accurate." *Id*. at 36.

testing only once (upon issuance of the contract), because an insurer would experience the same litigation risk if it were to develop a new annuity that is substantially similar to an existing unregistered annuity, and determines that the new annuity is a security due to current assumptions. This dilemma underscores the fact that a rule designed to define contracts as securities simply does not work.

V. No Rule Requiring Registration of Fixed Indexed Annuities Should Be Adopted Without the Concurrent Adoption of Other Rule and Form Amendments To Provide a Reasonable and Rational Scheme for Registration and Regulation

Proposed Rule 151A would, in practice, require the registration of all fixed indexed annuities as securities under the Securities Act of 1933[87] (the "1933 Act"). The Proposing Release takes the position that purchasers invest in fixed indexed annuities for much the same reason as purchasers invest in variable annuities (and that they bear much the same investment risk), and it is said that fixed indexed annuities are sold in direct competition with variable annuities. The Proposing Release supports Proposed Rule 151A largely by equating fixed indexed annuities with variable annuities. While we disagree with those positions, it nevertheless follows from them that, at least with respect to the federal securities laws, if registration of fixed indexed annuities is required, then both types of products should be subject to comparable registration and other requirements.

Over the last several decades, the Commission has adopted a number of special forms and rules that accommodate the continuous registration and continuous offering of variable annuities (as well as mutual funds) and has adopted rational and well reasoned approaches for variable annuities under various provisions of the federal securities laws. If registration of fixed indexed annuities is required, it would put them at a tremendous competitive disadvantage, and on a very unlevel playing field, if the same or comparable accommodations adopted for variable annuities were not also made for fixed indexed annuities. In this regard, as noted below we commend the Commission and wholeheartedly endorse (with modifications recommended below) its Proposed Rule 12h-7 under the Securities Exchange Act of 1934 (the "1934 Act"), which will avoid subjecting issuers of fixed indexed annuities to burdensome, unnecessary and costly reporting requirements under the 1934 Act, just as registering a variable annuity does not subject the insurer to those 1934 Act reporting requirements.

However, there are a number of other areas where changes or modifications are absolutely necessary to accommodate the registration of fixed indexed annuities and put them on a level playing field with competitive variable annuity products. The registration and regulatory structure of the 1933 Act was clearly not designed with fixed indexed annuities in mind, and without appropriate modifications a number of requirements make very little sense in the context of fixed indexed annuities and are of little or no use to investors. These include the following:

- **Registration Form.** Variable annuities are registered on Form N-4, which was designed and tailored specifically for that product. Form N-4 requires detailed

---

[87] The Proposing Release, at p. 64, assumes that all indexed annuities that are offered will be registered.

disclosure about the contract being offered, but very little about the insurance company (other than its financial statements). In contrast, most fixed indexed annuities would have to be registered on Form S-1,[88] a general purpose form that is ill-suited for fixed indexed annuities. It is cumbersome and expensive, and many of its disclosure requirements are of no benefit to purchasers of fixed indexed annuities, and indeed those required disclosures would only obscure information that is important to investors in those products. Form S-1 focuses on disclosure about the company, which is of course relevant to those who might be buying stock or otherwise investing in the company. However, for purchasers of fixed indexed annuities, information about the product is also relevant. We therefore recommend that either (a) Form S-1 be amended so that its requirements for fixed indexed annuities are appropriate,[89] or (b) Form N-4 be amended to provide for its use for registration of fixed indexed annuities.[90]

- **Financial Statements – Statement of Additional Information.** Form S-1 currently would require that the insurance company's complete financial statements be included in every prospectus.[91] This is a costly exercise that provides little or no benefit to most prospective purchasers of fixed indexed annuities. On the other hand, issuers of variable annuities registered on Form N-4 are not required to include financial statements in the prospectus; instead, their financial statements are included in the registration statement in a different document, called the "Statement of Additional Information," that is not required to be delivered to investors unless requested. Therefore, we request that a similar arrangement be put be in place for fixed indexed annuities, either by allowing their registration on Form N-4 or by amendments to Form S-1.

- **Financial Statements – Statutory vs. GAAP.** Insurance companies are required to prepare "statutory" financial statements each year to meet insurance department annual filing requirements. Regulation S-X generally requires that financial statements in SEC registration statements be prepared in accordance with generally

---

[88] A few issuers might qualify to use Form S-3.

[89] Some of the requirements of Form S-1, by reference to particular Items of Regulation S-K, that should not apply to a prospectus for fixed indexed annuities are: Item 101, a discussion of the issuer's business over the previous five years, including financial information about business segments and geographic areas; Item 301, selected financial data for the last five years; Item 303, management's discussion and analysis of financial condition and results of operations (including liquidity, capital resources and results of operations); Item 305, quantitative and qualitative disclosure about market risk; Items 401 and 402, information about directors and executive officers, including their involvement in certain legal proceedings, transactions with the company, and comprehensive details about executive compensation; Item 403, security ownership of beneficial owners and management; Item 404, disclosure regarding certain relationships and related transactions; and Items 504 – 508, information regarding use of proceeds, determination of offering price, dilution, and plan of distribution.

[90] Alternatively, a new form could be adopted for fixed indexed annuities.

[91] In some cases, companies that file periodic reports under the Securities Exchange Act of 1934 might be able to incorporate the financial statements by reference to those reports (*e.g.*, Form 10-K reports). However, this option is not available to most issuers of fixed indexed annuities, and indeed Proposed Rule 12h-7 would provide that registering a fixed indexed annuity would not, in itself, require the filing of such reports.

accepted accounting principles ("GAAP"), which entails an extra and substantial expense. However, for variable annuities, Form N-4 allows the use of statutory, rather than GAAP, financial statements in certain limited circumstances, *i.e.*, if the insurance company would not have to prepare GAAP financial statements except for use in variable annuity registration statements.[92] No real purpose would be served by requiring issuers of fixed indexed annuities to bear the cost and burden of preparing GAAP financial statements, if they meet the conditions in Form N-4 to use statutory financials in variable annuity registration statements. Accordingly, if fixed indexed annuities cannot be registered on Form N-4, then we respectfully request that Form S-1 be amended to permit the use of statutory financial statements in such circumstances.[93]

- **Registration of An Indefinite Amount of Securities.** In a typical securities offering registered on Form S-1, the company must register a particular dollar amount of securities and pay a registration fee based on that amount. Selling or issuing more than that dollar amount, inadvertently or otherwise, results in selling unregistered securities, which of course has very dire legal consequences. This is not a problem for a typical securities offering (which generally is a 'one-time' limited event), but could be a very serious problem for issuers of variable annuities (and other investment company securities, such as mutual funds) since they are sold in continuous offerings over many years, and in unlimited amounts, so constant monitoring would be required. For this reason, Section 24(f) of the Investment Company Act of 1940 provides that these types of securities[94] are deemed to be registered in an indefinite amount, and that registration fees are paid annually, in arrears, when the dollar amount sold is known.[95] It also provides that registration fees are based on the net amount sold, *i.e.,* on gross sales less redemptions. We recommend that the same treatment be accorded to fixed indexed annuities, through amendments to Rule 24f-2 under the Investment Company Act, to provide, with respect to fixed indexed annuities, (1) for the registration of an indefinite amount of securities, (2) for the payment of registration fees annually, in arrears, and (3) to specify that registration fees will be based on the net amount sold.

- **Automatic Effectiveness of Annual Post-Effective Amendments.** As noted above, the regulatory scheme of the 1933 Act is based on a limited, defined, "one-time" offering of securities. However, like variable annuities (and mutual funds), fixed indexed annuities are offered on a continuous basis, year after year. This means that

---

[92] Item 23(b) of Form N-4, *Instructions* 1. For variable life insurance registration statements, there is a similar exception to the GAAP requirement in Item 24(b) of Form N-6.

[93] Like GAAP financial statements, statutory financial statements are required to be audited (with the same exceptions for certain interim period financial statements).

[94] This includes securities issued by unit investment trusts, and virtually all variable annuity separate accounts are registered as unit investment trusts.

[95] Section 24(f) is implemented by Rule 24f-2. The registration fees are paid through the filing of Form 24F-2 annually.

the registration statement, including the prospectus, must be re-filed and updated annually, by Post-Effective Amendments to the registration statement, so that the financial statements and other information do not become stale.[96] Under the current regulatory scheme, for fixed indexed annuities, every such post-effective amendment to a registration statement on Form S-1 would have to be reviewed by the Commission staff, and then the staff must exercise their discretion to declare each individual post-effective amendment effective.[97] However, for variable annuities (and certain other investment company securities), Rule 485 under the 1933 Act provides procedures whereby post-effective amendments to registration statements can go effective automatically, through lapse of time.[98] We recommend that Rule 485 be amended so that it provides equal treatment with respect to fixed indexed annuities and variable annuities.

- **The Use of Advertisements.** The 1933 Act generally prohibits or places strict limits on advertisements for securities.[99] However, Rule 482 under the 1933 Act generally allows advertisements for variable annuities (and for securities of other investment companies) and permits those advertisements to include historical performance information, subject to certain conditions. Rule 482 is not available with respect to fixed indexed (or other fixed) annuities, and other advertising rules are of little or no use for most issuers of fixed indexed annuities.[100] We therefore recommend that Rule 482 be revised to permit its use for fixed indexed annuities.

- **The FINRA Corporate Financing Rule.** The Financial Industry National Regulatory Authority (FINRA, formerly the NASD) Rule 2710, the Corporate Financing Rule, requires that, before participating in a public offering of securities, certain documents and information must be filed with FINRA. Rule 2710 also contains detailed limitations on compensation that can be paid for the distribution of

---

[96] Section 10(a)(3) of the 1933 Act provides that the information in a prospectus cannot be more than 16 months old at the time the prospectus is used. Insurance companies are required to have fiscal years ending on December 31, so to affect a continuous offering of registered insurance products (whether fixed or variable) they must update their registration statement by filing a post-effective amendment that goes effective by May 1 of every year.

[97] It is standard industry practice that virtually all registration statements, including post-effective amendments thereto, are filed with a 'delaying amendment' so that they do not go effective automatically.

[98] Under paragraph (a) of Rule 485, a post-effective amendment for an insurance company separate account, such as one used for variable annuities, goes effective automatically in between 60 and 80 days after filing. Under paragraph (b) of Rule 485, certain post-effective amendments can go effective automatically immediately upon filing, or within 30 days thereafter.

[99] These prohibitions and restrictions arise from a number of sources, but they can generally be derived from Section 2(a)(10) of the 1933 Act, which includes advertisements in the definition of a 'prospectus,' in conjunction with Section 10(a), which generally requires that a 'prospectus' shall contain the information contained in the registration statement (with certain exceptions), and Section 5(b)(1), which prohibits the use of a prospectus that does not meet the requirements of Section 10(a).

[100] Rules 164 and 433 under the 1933 Act, the "free writing prospectus" rules, would require an issuer of fixed indexed annuities that is not a 'well-known seasoned issuer' (as defined in Rule 405) to deliver the full 'statutory' prospectus (as defined in Section 10) before or with the use of a 'free writing prospectus.'

> securities, and includes other limitations on public offerings. However, offerings of variable annuities are specifically exempt from Rule 2710.[101] We realize that FINRA is not part of the Securities and Exchange Commission. Nevertheless, as part of it efforts to ensure a level playing field for fixed indexed and variable annuities, we urge the Commission to consult with and encourage FINRA to exempt fixed indexed annuities from Rule 2710.

If the Commission decides to go forward with a rule that would require the registration of some (or all) fixed indexed annuities, no such rule should be adopted (or have an effective date) before the full regulatory framework has been revised in at least the ways noted above to more fully encompass indexed annuities in a rational and reasonable manner.

VI. Legal Obstacle to Registering Existing Fixed Indexed Annuities

The Release assumes that insurance companies can simply prepare a registration statement (including a prospectus) for their fixed indexed annuities, file the registration statement with the SEC, and after the SEC staff declares the registration statement effective, just go on to keep selling the annuity but doing so as a security. Unfortunately, however, the most basic provisions of the Securities Act of 1933 present a serious legal obstacle to doing that. The Release completely ignores this serious problem.

The prohibitions found in section 5 of the Act are the basic provisions designed to prevent the public offering and sale of securities unless adequate information about them has been made available to the public (*i.e.,* to potential investors). Individually and collectively, these provisions make it legally perilous, if not legally impossible, to register a fixed indexed annuity that is currently being sold. First, Section 5(c) prohibits any offers prior to the filing of the registration statement. An actual sale would seem to necessarily involve an offer. Accordingly, if an insurance company files a registration statement for one of its fixed indexed annuities, would all sales of that product prior to that filing somehow <u>retroactively</u> become illegal, in violation of Section 5(c), even though such sales were perfectly legal when they were made?

Second, Section 5(a) prohibits any sales of the security prior to the effective date of the registration statement. Again, if an insurance company such as Midland has filed a registration statement for one of its fixed indexed products that it is currently selling, are sales prior to the effective date, although legal when made, somehow <u>retroactively</u> illegal, simply because Midland complied with a new Rule 151A and filed a registration statement, which has not yet become effective?

Third, the prohibitions of Sections 5(b)(1) and 5(b)(2) also present significant legal issues, since Midland would not have a statutory prospectus (meeting the requirements of Section 10 of the Act) when it is selling existing products prior to the filing or effectiveness of a registration statement, filed in order to comply with new Rule 151A.

---

[101] Subsection (b)(8)(D) of Rule 2710.

Moreover, it would be no solution for the Commission to state that under these circumstances, it will take no enforcement action against issuers of fixed indexed annuities merely because they register products that they are currently selling, because Section 12(a) of the Act gives purchasers a private right of action against any person who offers or sells a security in violation of Section 5. The legal and other costs involved would be considerable and are not taken into account in the Release.[102]

Theoretically, Midland could continue selling its existing products, and design new and different fixed indexed products to be registered as securities. However, any such endeavors would defy common sense. It would mean designing products, for purchase by investors, where the product design and features are intended <u>solely</u> to differentiate the new product from Midland's existing products, rather than to provide new or additional benefits to investors or otherwise offer a better product to investors. Aside from how ridiculous this effect of the Commission's proposal would be,[103] this would obviously involve very significant and very considerable expenses that the Release's cost/benefit analysis does not take into account.

A possible alternative approach that insurance companies could, again theoretically, take is to stop sales of existing fixed indexed annuities for a considerable period of time (at least six months, and more probably a year or more), while the company files a registration for the product(s) and then goes through the considerable and time-consuming process of waiting for the SEC staff to provide comments on the registration statement, react to the company's amended registration statement (or amendments) filed in response to the staff's comments, provide additional comments, react to another pre-effective amendment, resolve comments, and finally declare the registration statement effective. In other words, this approach would mean that Midland would need to stop sales of its existing fixed indexed annuity products for one year or more. This business interruption would be more than significant and enormously expensive in terms of lost sales. This would be extremely harmful not only to Midland and the thousands of consumers who have benefitted from Midland's fixed indexed annuities, but also to the thousands of individual agents, and small business agencies, that sell the products.

The Release certainly does not take these very significant costs – to insurance companies, insurance agents and agencies, and indirectly purchasers of the products – into account in its purported cost/benefit analysis.

The Commission's proposed Rule 151A is therefore contrary to the protection of investors. Since the proposal does not address how companies currently selling fixed indexed

---

[102] Insurance companies incur considerable expense to sell a product, including but not limited to sales commissions, which they intend to recoup through profits if the product stays in force, or through surrender charges if the product is surrendered prematurely. However, if owners of fixed indexed annuities are able to rescind their purchase under Section 12(a) of the Act, the insurance company would not be able to recoup its selling expenses. This could be a very significant expense that is not taken into account in the Release.

[103] This could very well involve new product designs that provide significantly less guarantees and protections for investors than existing fixed annuity product designs. In this regard, the Commission's proposal, rather than protecting investors, would actually <u>harm</u> investors in fixed indexed annuities.

annuities can register those products as securities without running afoul of the Section 5 prohibitions discussed above, the proposal is arbitrary and capricious and should be withdrawn.

VII. A 12-Month Implementation Deadline is Insufficient

A deadline of 12 months to come into compliance with Proposed Rule 151A is grossly insufficient for a number of reasons.

First, it will take at least that long, and probably significantly longer, for companies and their actuaries to determine which of their products would be securities that would have to be registered. As discussed above, actuaries would have to make sophisticated and complex assumptions and assessments under the "more likely than not" test. A large number of very significant assumptions will have to be made (subject to second guessing and potential legal liability) and this task alone will take considerable time and effort. It seems likely that the test would then have to be applied using a variety of different assumptions, and thousands upon thousands of scenarios would need to be run and assessed. And, as noted above, it is unlikely that this work can really be done in the absence of a relevant Actuarial Standard of Practice (the potential legal risk in proceeding without such a standard would be enormous).

Then companies will need a significant amount of time to make important decisions regarding whether to register each of their products, to stop sales of one or more products, and/or to design new products.

Registration of products will itself take a considerable amount of time. It usually takes several months to prepare a registration statement, and it can take longer where, as here, there is no registration form designed for these products (see discussion of Registration Form, above). Then, after a registration statement is filed, it takes many months, and has and can taken more than a year, to get through the SEC review process, especially where, as here, there is no registration statement form designed for these products. And that is with a "normal" volume of registration statements for the SEC staff to process; if this rule is adopted, it would trigger the filing of hundreds of registration statements (and subsequently advertising) in roughly the same time period and clearly the SEC staff would simply be overwhelmed.

Companies are likely to design new products, either to avoid SEC registration or to take advantage of SEC registration (for example, if a company decides to register a product, it might very well decide to reduce or eliminate some or all guarantees, or to change its marketing to promote the product as an investment). Either way, designing new products will take time, and then it will take time to file with and where necessary get approvals of state insurance departments.

In addition, changing the status of fixed indexed annuities from insurance to securities will require that insurance agents currently selling, or who want to sell, fixed indexed annuities become licensed as securities salespersons (*i.e.*, as registered representatives of a broker-dealer). The amount of training and testing, for literally thousands of insurance agents, would be enormous and take considerable time, and may very well overwhelm FINRA's CRD system for testing, licensing, and registration. Moreover, some insurance companies may very well need to create a new broker-dealer and have some of its officers trained to become principals; each such broker-dealer would need to develop many written compliance policies and procedures, and establish the necessary and required books and records. This alone usually takes far longer than a mere 12 months.

In short, Proposed Rule 151A is such a fundamental and profound change, with such far-reaching and enormous consequences, that actually implementing it is clearly a multi-year undertaking.

VIII. Proposed Rule 12h-7 under the Securities Exchange Act of 1934

In addition to Rule 151A, the Commission has proposed the adoption of Rule 12h-7 under the Securities Exchange Act of 1934 (the "Exchange Act"). Rule 12h-7 would provide that insurance companies are not subject to the reporting requirements of Section 13 and 15(d) of the Exchange Act merely because they register a fixed indexed annuity (or other non-variable insurance product) as a security under the Securities Act of 1933.

Midland strongly supports the adoption of a rule that would provide those exemptions, and commends the Commission for proposing Rule 12h-7. However, proposed Rule 12h-7 contains a serious flaw that makes it unworkable. Specifically, paragraph (e) of the proposed rule would require insurance companies to require written notice to, and acceptance by, the issuer prior to any assignment of the fixed indexed annuity. It would also require the issuer to reserve the right to refuse any assignment. However, a number of state insurance departments simply will not allow an insurance company to restrict assignments in that manner. They regard the ability to assign a contract as a policy owner's right, and one that cannot be abrogated by an insurance company.[104] Accordingly, if any such provision remains in Rule 12h-7, it must be modified by some qualifier such as "Where permitted by law and by administrative or other positions of state insurance departments … ."

However, we respectfully submit that this condition is simply unnecessary and should just be eliminated. Paragraph (d) of proposed Rule 12h-7 would provide that the securities (*e.g.*, the fixed indexed annuity) are not listed, traded, or quoted on an exchange, or any other similar system or network. Paragraphs (d) and (e), then, are two different attempts to realize the same goal - that there be no secondary trading market in these insurance products. The condition in paragraph (d) is clear, provides an objective standard, is workable, and protects against the possibility of there being a secondary trading market. Paragraph (e), however, is simply unworkable, unnecessary, and should be eliminated.

---

[104] *See, e.g.*, UTAH CODE ANN. § 31A-22-412.

IX. Insufficient Comment Period

It has taken a tremendous effort to perform even a preliminary analysis of the proposed rules in the short comment period provided, given the significant and far-reaching scope of the proposals. We have not completed our analysis, and significant additional time is needed to adequately consider the affects and consequences of the proposed rules. Midland, along with a number of others, has requested an extension of the comment period.[105] There are undoubtedly additional arguments that can and should be made, and additional information that should be provided, in support of the points made in this letter. Moreover, in the time allotted we have not been able to address all of the issues that we believe should be addressed. We therefore respectfully request that the Commission re-open the comment period for at least another 90 days so that we can complete our analysis and provide the most complete, thoughtful and constructive comments possible.

* * *

We thank the Commission for the opportunity to comment on these proposals.

Sincerely,

Esfandyar E. Dinshaw
President, Sammons Annuity Group
Midland National Life Insurance Company
North American Company for Life and Health Insurance

---

[105] See letter dated August 7, 2008, from Esfand Dinshaw, President, Sammons Annuity Group, in SEC File No. S7-14-08.

Exhibit A

MNL SELECT℠ SERIES
ANNUITY DISCLOSURE STATEMENT

MIDLAND NATIONAL®
Life Insurance Company • Annuity Division
4601 Westown Parkway • Suite 300 • West Des Moines, IA 50266

The MNL Select℠ Series is a flexible premium deferred fixed annuity that accumulates interest in the following ways: A) based on the change in the Index Account during each contract year, without the risk of losing premium due to market volatility, and/or B) a traditional Fixed Account. You have the ability to choose from a 6-, 8-, 10- or 14-year surrender charge option. You also have the ability to choose from a 5% or 10% penalty-free withdrawal option.

Fixed Account: The initial premium allocated to this account will earn the initial premium interest rate. This rate will be guaranteed for one contract year. The Fixed Account interest rate will be declared for subsequent premiums and future durations. This rate will never fall below the minimum guaranteed Fixed Account interest rate. Ask your sales representative for both the current and minimum interest rates.

Index Accounts: The initial premium allocated to the Index Accounts will earn an interest credit that is based on changes in the available index(es) for the following Index Accounts:

- Annual Point-to-Point
- Monthly Point-to-Point

Please see the MNL Select℠ Series product brochure for specific details regarding the Index Accounts.

Index Cap Rate: An Index Cap Rate is applied to each of the Index Accounts. This rate, which is based upon current economic conditions, is declared at issue and on each contract anniversary and is guaranteed for the next contract year. Upon issue, the minimum Index Cap Rate will be guaranteed for the entire term of your contract. Please refer to your product brochure for the minimum Index Cap Rates. Ask your sales representative for the current Index Cap Rate. An Index Cap Rate does not apply to the Fixed Account.

Initial Premium: For Initial Premium amounts of $250,000 or more, you will receive higher Fixed Account Interest Rates and Index Cap Rates. Please ask your sales representative for current interest rates and Index Cap Rates.

Subsequent Premiums: All subsequent premiums will be credited at the current Fixed Account interest rate until the next contract anniversary. On each contract anniversary, Midland National will allocate any premiums received since the prior contract anniversary among the Fixed and Index Accounts, according to your most recent instructions.

Accumulation Value: Your Accumulation Value is the sum of the Index Account values plus the Fixed Account value.

Surrender Value: The Surrender Value is the amount that is available at the time of surrender. The Surrender Value is equal to the Accumulation Value, subject to the Interest Adjustment, less applicable surrender charges and state premium taxes. The Surrender Value will never be less than the minimum requirements set forth by state laws at the time of issue.

Surrender Charges: Surrender charges allow the Company to invest your money on a long-term basis. A surrender charge will be assessed in the event of a full or partial surrender exceeding the penalty-free withdrawal limit. This allows the Company to credit higher yields as compared to a similar annuity of a shorter term.

Surrender charges and Interest Adjustments are not waived on IRS-Required Minimum Distributions that exceed the penalty-free amount for the 5% penalty-free option. However, surrender charges and Interest Adjustments on IRS-Required Minimum Distributions that exceed the penalty-free amount are waived by current Company practice for the 10% penalty-free option. **Please keep in mind that a surrender during the surrender charge period may result in a loss of premium.**

Interest Adjustment: The MNL Select℠ Series includes an Interest Adjustment, which generally allows the Company to credit higher interest rates than on products without an Interest Adjustment. It is applied only during the surrender charge period to full surrenders and to any partial surrender in excess of the penalty-free amount. This adjustment may increase or decrease the Surrender Value depending on the change in interest rates during the period since you purchased your MNL Select℠ Series annuity. See the “Understanding the Interest Adjustment” brochure for more information. **Note: Not applicable in all states.**

Transfer Options: You may transfer values between the Fixed Account and the Index Accounts, as well as transferring among any available index(es) within each Index Account, on each contract anniversary. Transfers are subject to minimums; please see your annuity contract for details.

Death Benefit: Midland National will pay out, as the Death Benefit, the full Accumulation Value to your beneficiary upon the death of the owner or annuitant. Note: If joint annuitants are named in the annuity, the Death Benefit will be paid at the second death. If joint owners are named in the annuity, the Death Benefit will be paid at the first death.

The MNL Select℠ Series is not a registered security and does not directly participate in stock or equity investments. Past index performance is not intended to predict future performance and the Index does not include dividends. Refer to contract for complete details. The use of living trusts with the sale of an annuity product can, in the appropriate circumstances, be a valuable planning device. Midland National strongly encourages you to consult your tax or legal advisor before establishing a living trust or purchasing any financial product in connection with utilizing a living trust. Neither Midland National, nor any agents acting on its behalf, should be viewed as providing legal, tax or investment advice. Consult a qualified advisor.

LIQUIDITY PROVISIONS:

Penalty-Free Withdrawals; Once per year after the first contract anniversary, you may withdraw, without surrender charges or Interest Adjustment, up to 5% or 10% of your Accumulation Value, depending on the option you elect below. Certain withdrawals prior to age 59½ may be subject to an IRS penalty.

Annuitization Benefit: By current Company practice, proceeds may be converted to an annuity payment option after year one. Income payments will be based on the Accumulation Value if a Life, Life and Certain or Joint Life option is selected, or if the annuity has been in force for at least five years and payments are received over at least a five-year period (ten years on the 14-year option).

Additional Benefit Rider: The following benefit rider covers the annuitant and will be automatically added to your annuity in states where available. Please see the MNL Select[SM] Series product brochure for specific details regarding the rider.

- **Nursing Home Confinement Rider -** For annuitants age 75 and younger.

Required Minimum Distributions: Surrender charges and Interest Adjustments on IRS-Required Minimum Distributions exceeding the penalty-free withdrawal amount will not be waived by current Company practice for the 5% Penalty-Free Withdrawal Option. However, Surrender Charges and Interest Adjustments will be waived by current Company practice for the 10% Penalty-Free Withdrawal Option.

These liquidity provisions are suitable for my financial needs, such as cash for living and other related expenses. This contract is suitable for my financial needs.

Payment of Commissions: Midland National will pay compensation to the sales representative(s) for the sale of this annuity. Incentive compensation may also be paid to the sales representative. Commission amounts are not deducted from the submitted premium. One hundred percent (100%) of any premium payments will be applied to this annuity. First-year commissions are the same for each product option.

APPLICANT: I have received a copy of the product brochure and Company disclosure material for this contract. I understand that any values shown, other than the guaranteed minimum values, are not guarantees, promises or warranties.

Note: Before purchasing an annuity for use in a qualified plan, you should obtain competent tax advice, both as to the treatment and suitability of such an annuity contract. An annuity is not required for tax deferral in qualified plans.

I understand that the MNL Select[SM] Series annuity is a long-term contract with substantial penalties for early surrenders. A surrender charge is assessed, as listed below, on any amount withdrawn, whether as a partial withdrawal or full surrender, that is in excess of the penalty-free amount applicable. The surrender charges vary by product option and decline as follows:

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15+
6 Year	9.00%	9.00%	8.00%	6.00%	4.00%	2.00%									
8 Year	9.00%	9.00%	8.00%	7.00%	6.00%	5.00%	4.00%	2.00%							
10 Year	9.00%	9.00%	8.00%	7.00%	6.00%	5.00%	4.00%	3.00%	2.00%	1.00%					
14 Year	9.00%	9.00%	9.00%	9.00%	8.00%	8.00%	7.00%	7.00%	6.00%	6.00%	5.00%	4.00%	3.00%	2.00%	

Surrender charges allow the Company to invest long-term, and in turn, generally credit higher yields.

Surrender Charge Option	6-year surrender charge	8-year surrender charge	10-year surrender charge	14-year surrender charge
Owner(s): Please initial the space next to "elect" for the surrender charge option chosen, and initial the spaces next to "decline" for the other three options.	Elect ________	Elect ________	Elect ________	Elect ________
	Decline ________	Decline ________	Decline ________	Decline ________

Penalty-Free Withdrawal Option AVAILABLE WITH ALL SURRENDER CHARGE OPTIONS	5% Penalty-Free Withdrawal	10% Penalty-Free Withdrawal
Owner(s): Please initial the space next to "elect" for the Penalty-Free Withdrawal Option Chosen and initial the space next to "decline" for the other option.	Elect ________	Elect ________
	Decline ________	Decline ________

Annuitant/Owner's Signature	Date Signed (mm/dd/yyyy)
Joint Owner's Signature	

AGENT: I certify that the product brochure and Company disclosure material have been presented to the applicant. A copy was provided to the applicant. I have made no statements which differ in any significant manner from this material. I have not made any promises or guarantees about the future value of any non-guaranteed elements.

Agent's Signature	Date Signed (mm/dd/yyyy)

The **MNL Select[SM] Series** is issued by Midland National Life Insurance Company, West Des Moines, Iowa on form AC124A (group certificate) or AS124A (individual contract), AR151A, AR153A, AR158A, AR159A, AR160A, AR163A (riders) or appropriate state variation. This product, its features and riders may not be approved in all states. The tax-deferred feature is not necessary for a tax-qualified plan. In such instances, you should consider whether other features, such as the Death Benefit, lifetime annuity payments and optional riders make the contract appropriate for your needs. Before purchasing this annuity contract, you should obtain competent tax advice both as to the tax treatment of the contract and the suitability of the investment.

CLIENT'S ORIGINAL SIGNATURE MUST BE ON THIS PAGE. RETURN THIS PAGE TO HOME OFFICE. DISCLOSURE COPY WITH CARBONED SIGNATURE REMAINS WITH APPLICANT.

LIQUIDITY PROVISIONS:

Penalty-Free Withdrawals; Once per year after the first contract anniversary, you may withdraw, without surrender charges or Interest Adjustment, up to 5% or 10% of your Accumulation Value, depending on the option you elect below. Certain withdrawals prior to age 59½ may be subject to an IRS penalty.

Annuitization Benefit: By current Company practice, proceeds may be converted to an annuity payment option after year one. Income payments will be based on the Accumulation Value if a Life, Life and Certain or Joint Life option is selected, or if the annuity has been in force for at least five years and payments are received over at least a five-year period (ten years on the 14-year option).

Additional Benefit Rider: The following benefit rider covers the annuitant and will be automatically added to your annuity in states where available. Please see the MNL Select℠ Series product brochure for specific details regarding the rider.

• Nursing Home Confinement Rider - For annuitants age 75 and younger.

Required Minimum Distributions: Surrender charges and Interest Adjustments on IRS-Required Minimum Distributions exceeding the penalty-free withdrawal amount will not be waived by current Company practice for the 5% Penalty-Free Withdrawal Option. However, Surrender Charges and Interest Adjustments will be waived by current Company practice for the 10% Penalty-Free Withdrawal Option.

These liquidity provisions are suitable for my financial needs, such as cash for living and other related expenses. This contract is suitable for my financial needs.

Payment of Commissions: Midland National will pay compensation to the sales representative(s) for the sale of this annuity. Incentive compensation may also be paid to the sales representative. Commission amounts are not deducted from the submitted premium. One hundred percent (100%) of any premium payments will be applied to this annuity. First-year commissions are the same for each product option.

APPLICANT: I have received a copy of the product brochure and Company disclosure material for this contract. I understand that any values shown, other than the guaranteed minimum values, are not guarantees, promises or warranties.

Note: Before purchasing an annuity for use in a qualified plan, you should obtain competent tax advice, both as to the treatment and suitability of such an annuity contract. An annuity is not required for tax deferral in qualified plans.

I understand that the MNL Select℠ Series annuity is a long-term contract with substantial penalties for early surrenders. A surrender charge is assessed, as listed below, on any amount withdrawn, whether as a partial withdrawal or full surrender, that is in excess of the penalty-free amount applicable. The surrender charges vary by product option and decline as follows:

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15+
6 Year	9.00%	9.00%	8.00%	6.00%	4.00%	2.00%									
8 Year	9.00%	9.00%	8.00%	7.00%	6.00%	5.00%	4.00%	2.00%							
10 Year	9.00%	9.00%	8.00%	7.00%	6.00%	5.00%	4.00%	3.00%	2.00%	1.00%					
14 Year	9.00%	9.00%	9.00%	9.00%	8.00%	8.00%	7.00%	7.00%	6.00%	6.00%	5.00%	4.00%	3.00%	2.00%	

Surrender charges allow the Company to invest long-term, and in turn, generally credit higher yields.

Surrender Charge Option	6-year surrender charge	8-year surrender charge	10-year surrender charge	14-year surrender charge
Owner(s): Please initial the space next to "elect" for the surrender charge option chosen, and initial the spaces next to "decline" for the other three options.	Elect ______	Elect ______	Elect ______	Elect ______
	Decline ______	Decline ______	Decline ______	Decline ______

Penalty-Free Withdrawal Option	5% Penalty-Free Withdrawal	10% Penalty-Free Withdrawal
Owner(s): Please initial the space next to "elect" for the Penalty-Free Withdrawal Option Chosen and initial the space next to "decline" for the other option.	Elect ______	Elect ______
	Decline ______	Decline ______

Annuitant/Owner's Original Signature	Date Signed (mm/dd/yyyy)
Joint Owner's Original Signature	

AGENT: I certify that the product brochure and Company disclosure material have been presented to the applicant. A copy was provided to the applicant. I have made no statements which differ in any significant manner from this material. I have not made any promises or guarantees about the future value of any non-guaranteed elements.

Agent's Original Signature	Date Signed (mm/dd/yyyy)

The MNL Select℠ Series is issued by Midland National Life Insurance Company, West Des Moines, Iowa on form AC124A (group certificate) or AS124A (individual contract), AR151A, AR153A, AR158A, AR159A, AR160A, AR163A (riders) or appropriate state variation. This product, its features and riders may not be approved in all states. The tax-deferred feature is not necessary for a tax-qualified plan. In such instances, you should consider whether other features, such as the Death Benefit, lifetime annuity payments and optional riders make the contract appropriate for your needs. Before purchasing this annuity contract, you should obtain competent tax advice both as to the tax treatment of the contract and the suitability of the investment.