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United States Securities and Exchange Commission
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E-mail filing address: rule-comments@sec.gov

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Re: Proposed Rulemaking Regarding Fixed Index Annuities
File No. S7-14-08

Dear Commissioners and Staff:

This letter is being sent to the Commission on behalf of Allianz Life Insurance Company of North America ("Allianz," "the Company," "we," "us," or "our") to provide comments on the Commission's recent proposed rulemaking (the "Rule Proposal") pertaining to fixed index annuities ("FIAs"). We appreciate this opportunity to provide comments on this significant proposal.

Allianz issues FIAs and is a prominent participant in that segment of the insurance industry. As of December 31, 2007, Allianz had $40 billion of FIA assets under management ("AUM"). This represents 33% of all FIA AUM in the United States at that date. In addition to FIAs, Allianz issues a variety of other fixed insurance products, including traditional fixed annuities, fixed and index life insurance, and long term care insurance. Allianz and its subsidiaries also provide a variety of securities products and services, including variable annuities, mutual funds, securities brokerage, and securities investment advice.

Over the past few years, we have consistently repeated the following three themes.

1. PROPER FUNCTIONAL REGULATION OF THE PRODUCT. Our stance on the regulation of FIAs has not changed. We believe FIAs are insurance products – not securities. There are commonly accepted tests used to determine whether or not particular financial products meet the threshold required to constitute a security; FIAs do not meet these tests, and as such, should not be regulated as securities. Allianz clearly stated this position to the Commission in 2005 and 2006, and we continue to stand behind this position.

2. SALES PROCESS. We believe that FIA sales processes have evolved significantly over the last three to five years. As the industry leader in FIA sales, we have been in the forefront of the changes in the areas of suitability, disclosure, and agent practices. We believe our approach – built in partnership with regulators and industry groups – serves as a strong model upon which uniform industry standards can be completed. We will continue to work with the ACLI, NAIC, and other organizations and regulators to develop industry-wide standards and processes. Based on this background, we do not believe that SEC regulation of FIAs is necessary or appropriate.

We are concerned about statements in the Commission's Rule Proposal critical of FIA sales practices and sales agents. We do not believe these statements are supported by any available data. Further, we object to any negative implication regarding the character or business practices of the many thousands of honest, experienced sales agents who sell FIAs.

3. AGENT LICENSURE. We believe that any valid concerns about sales processes can be addressed without requiring insurance agents to obtain securities licenses. We have always worked with our agents who wish to become securities licensed, as well as those agents who are committed to remaining fixed insurance only agents, to assure compliance with all applicable requirements. However, we do not believe there is any noticeable benefit from a sales practice perspective to be derived from obtaining a securities license. We do not believe that securities licensure for FIA sales is necessary or appropriate.

This letter will provide information as to our approach to the FIA marketplace, and will also provide our detailed response to the specific issues raised by the Rule Proposal. We appreciate this opportunity to lend our thoughts, experience and expertise to the Commission's consideration of FIA regulation. Please do not hesitate to contact us if you have any questions or if you need any additional information.

THE RULE PROPOSAL

The Rule Proposal has two components. First, proposed Rule 151A sets forth an extremely narrow definition for "annuity contracts" and "optional annuity contracts" that would result in substantially all FIA contracts being regulated as "securities" under the Securities Act of 1933 (the "Securities Act"). (In the alternative, issuers that did not register their contracts would be required to rely on the statutory exemption for annuity contracts in Section 3(a)(8) of the Securities Act.) Second, proposed Rule 12h-7 provides that, if certain conditions are met, insurance company issuers registering FIAs and certain other types of insurance contracts with the Commission would not be subject to the periodic reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act") or the Sarbanes-Oxley Act of 2002.

SUMMARY OF ALLIANZ' POSITION ON THE RULE PROPOSAL

As is discussed in detail in this letter, Allianz' position on the Rule Proposal is:

- FIAs that satisfy state minimum nonforfeiture requirements and "lock in," or guarantee, previously credited interest are insurance, not securities, and should be regulated as insurance. State minimum nonforfeiture rules assure that annuity purchasers' principal and guaranteed interest is never in jeopardy when the annuity is held to maturity and therefore investment risk – the risk of loss of principal – remains at all times solidly with the insurer.

- The Rule Proposal is an attempt to re-write the provisions of Section 3(a)(8) of the Securities Act without appropriate legislation. The Rule Proposal pays but cursory attention to applicable Supreme Court precedent, and in some respects mischaracterizes that precedent. We appreciate that many people in the legislative and regulatory communities believe that the Securities Act, which is now over 70 years old, is antiquated and inadequate to regulate modern financial markets. However, re-writing the Securities Act requires definitive Congressional action, and is not within the jurisdiction of a single regulatory agency. The Securities Act represents a delicate balancing of numerous competing regulatory considerations pertaining to the securities, insurance, and banking industries. If the Commission believes that there is a flaw in the current provisions of the Act, it should inform Congress of its recommendations and await appropriate Congressional action.

- The Rule Proposal lacks any significant discussion of how insurance products differ from securities products and why different systems of regulation would be appropriate for different types of products. Clearly, by providing an exclusion for annuity contracts in the Securities Act, Congress recognized the benefits of different types of regulation, and continued that recognition with the adoption of the McCarran-Ferguson Act in 1945 and a reiteration of the pre-eminence of the McCarran-Ferguson Act in Section 104 of the Gramm-Leach-Bliley Act in 1999. The Commission is not the functional regulator of the insurance industry, and the Commission should not adopt rules that will have serious anti-competitive effects on the insurance industry without engaging in bilateral discussions with the state insurance regulators, rather than (and instead of) state securities regulators.

- The Rule Proposal is not in the best interests of consumers. The Rule Proposal would have the effect of reducing product availability and consumer choice. This would lead to some consumers being sold risky securities products, thereby exposing their accumulated assets to potentially significant losses.

- The collateral consequences and burdens of proposed Rule 151A to agents, marketers, and issuers of FIAs are, quite simply, enormous. If adopted as proposed, the rule would have a negative and unjustified impact on thousands of honest, experienced insurance agents and marketing organizations nationwide. We believe the Rule Proposal’s consideration of the costs and burdens of the proposed rule to insurance industry participants is deficient.

- If adopted as proposed, proposed Rule 151A will have a significant anticompetitive effect on FIA issuers and marketers. We believe the Rule Proposal’s consideration of this effect is deficient.

- If adopted as proposed, the rule will have a markedly negative effect on product availability and consumer choice, both with respect to FIAs and with regard to other non-securities insurance products.

  Among other things, if Rule 151A is adopted as proposed and FIAs are regulated as “securities,” agents selling FIAs will become subject to the “outside business activity” restrictions applicable to securities registered representatives in FINRA (NASD) Rules 3030 and 3040. These restrictions would require fixed insurance agents who obtain securities licenses in order to sell FIAs to submit all of their business activities – including non-securities activities – to their broker-dealer for approval or disapproval. This would subject the agents’ other fixed insurance businesses – including the sale of traditional fixed annuities, fixed life insurance, long-term care insurance, and disability insurance – to burdensome additional restrictions and oversight by broker-dealers. Not only is this contrary to the McCarran-Ferguson Act, as supplemented and endorsed by Section 104 of the Gramm-Leach-Bliley Act, but it remains to be seen whether third-party broker-dealers which have not previously supervised insurance sales – and in fact the leadership of FINRA – have the necessary expertise to competently fulfill this responsibility. In many instances, it could be expected that a broker-dealer firm may simply choose to prohibit sales by its representatives of fixed insurance products that it does not understand or sell. Moreover, FINRA is chiefly concerned with the oversight of securities sales practices, not the approval of forms of insurance or the safety and soundness of insurers. We question whether the Commission fully appreciates the effect that the Rule would have on product availability and consumer choice.

- While not expressly stated in the Rule Proposal, it seems clear that the Commission’s principal goal in this rulemaking is to subject FIA sales practices to Federal suitability standards, apparently based on the assumption that this will lead to enhanced consumer protection. Initially, we do not agree with the underlying assumption that proposed Rule 151A will provide greater consumer protection. Moreover, we believe that the Commission’s goals with regard to suitability review could be met with a substantially narrower rulemaking focused solely on sales practices.

- The Rule Proposal is also deficient in not providing a more tailored, streamlined approach to the regulation of FIAs. Put simply, FIAs would have to be registered on an inapplicable and highly cumbersome form, the Form S-1, and issuers will not have available any of the modern filing rules available to issuers of mutual funds and variable insurance, such as Rule 485 under the Securities Act and Rule 24f-2 under the Investment Company Act of 1940 (the "Investment Company Act"). Moreover, issuers will not be able to rely on Rule 482 under the Securities Act, and thus would be severely restricted in their ability to provide marketing materials on a standalone basis. The non-availability of these rules would increase the cost and administrative burden of registering FIAs substantially, would place FIA issuers at a disadvantage vis-à-vis mutual fund and variable insurance issuers, and would cause a significant anti-competitive effect on insurance companies issuing FIAs.

- From the perspective of the insurance industry, FIAs are fundamentally different from "securities." "Securities" are highly risky products. The purchaser of a security can lose some or all of their principal. In contrast, FIAs provide basic and significant guarantees, and the purchaser cannot lose principal other than on an early withdrawal. We agree that the Securities Act may have become out-of-date, but believe that some of the most significant deficiencies pertain to the regulation of risky securities products, not insurance. When the Securities Act was enacted, a very small segment of the population, less than 2%, invested in securities. Even as recently as the 1950s, less than 5% of the population invested in securities. The Securities Act clearly did not contemplate the current marketplace, where millions of consumers, many of them with minimal financial sophistication, are investing in risky securities products through 401(k)s, IRAs, and similar vehicles. And, these investment vehicles may be the only retirement savings that these consumers have. In this context, we seriously question why there is no discussion in the securities community of whether it is unsuitable to sell securities to seniors, or whether it is unsuitable to have more than some conservative percentage of assets in a 401(k) invested in the stock and bond markets. For the mass of consumers, who are not financial elites and may not read or understand a prospectus, the guarantees and protections of an insurance product would appear to be substantially more suitable than most securities products. In this context, we seriously question the public policy basis for any rule that would restrict the availability of these safer consumer products.

- We strongly support the adoption of proposed Rule 12h-7. The rule would rationalize and streamline the regulation of insurance company issuers. However, we do not believe it will be feasible for insurers to comply with the assignment condition of proposed Rule 12h-7. We recommend that a revised Rule 12h-7 be adopted at the earliest practicable date.

  We note that proposed Rule 12h-7 is not formally linked to proposed Rule 151A. While we do not support the proposed Rule 151A, if that rule is adopted in any form, we believe that its adoption should be contingent on the concurrent adoption of Rule 12h-7. If the Commission considers adopting proposed Rule 151A without adopting proposed Rule 12h-7, this should cause a substantial re-evaluation of the costs and burdens of proposed Rule 151A. Currently, the discussion of proposed Rule 151A in the Rule Proposal does not address the substantial burdens that the Exchange Act would impose on insurers registering FIA contracts.

- Because of the significance of the Rule Proposal, we request that the Commission extend the comment period for the Rule by 90 days, to allow the Company and other industry participants an adequate opportunity to review the Rule Proposal and comment.

1. REGULATION OF FIAS AS SECURITIES/PROPOSED RULE 151A

a. Analysis of the Applicability of the Federal Securities Laws to FIA Products

Allianz has consistently taken the position that FIAs which satisfy state minimum nonforfeiture requirements and "lock in," or guarantee, previously credited interest are insurance and not "securities," and should be regulated as insurance. We provided an extensive legal analysis on this issue to the Commission and its staff on September 7, 2005. We continue to believe that the analysis provided to the Commission accurately reflects the law pertaining to FIAs. We will not repeat here the arguments in that submission. Instead, we have included the legal analysis provided to the Commission in 2005 as Attachment 1 to this letter.

b. Proposed Rule 151A

We believe proposed Rule 151A is based upon flawed assumptions. In addition, the proposed rule is inadequately grounded in the applicable Supreme Court precedent regarding the proper interpretation of Section 3(a)(8). The proposed rule contains concepts found nowhere in Section 3(a)(8) or the case law interpreting Section 3(a)(8), and the proposal mischaracterizes several key concepts in the analysis of Section 3(a)(8), including the meaning of investment risk. We expect that most of these issues will be addressed in detail by insurance industry trade groups and legal committees. However, we highlight the following issues.

(i) <u>The Proposed Rule Is Based on Flawed Assumptions</u>

The Rule Proposal contains a number of incorrect assumptions.

First, the Rule Proposal asserts that, when purchasing FIAs, consumers intend to buy a "securities" product. The following statements are from the Rule Proposal:

> Indexed annuities are attractive to purchasers because they offer market-related gains. Thus, these purchasers obtain indexed annuity contracts for many of the same reasons that individuals purchase mutual funds and variable annuities, and open brokerage accounts.
>
> (Rule Proposal at page 5.)
>
> Indexed annuities are attractive to purchasers precisely because they offer participation in the securities market. Thus, individuals who purchase such indexed annuities are "vitally interested in the investment experience."
>
> (Rule Proposal at page 27.)

These statements, without any apparent empirical foundation or citation to a single demographic statistic of any kind, indicate several questionable assumptions. Initially, we believe that if a consumer wants to purchase a securities product, he or she will purchase a stock, bond, or shares of a mutual fund, and not an FIA. Further, it is important to point out that the purchaser of any financial product – whether an annuity, a bank CD, or a security – is "vitally interested in the investment experience." We do not believe this interest can be characterized as a hallmark of a securities product.

More importantly, we believe that consumers purchase FIAs **because FIAs are not securities and are not subject to the substantial risk of the securities markets.**

The goal of consumers purchasing FIAs – to obtain financial security via principal protection and income for life – is borne out by a cursory analysis of sales trends for FIAs. As the Commission is aware, the FIA market grew at a very rapid rate between 2001 and 2004. This sales growth coincided with a collapse in the equity securities markets during that period. The growth of FIA sales during this period strongly suggests the conclusion that consumers were purchasing FIAs primarily as a means to avoid the risks of the securities markets.

As part of its sales process, Allianz surveys all purchasers of its FIAs to determine the reason each customer purchased an FIA. For the year 2008 through August 31, we collected over 51,000 statements from customers as to their reasons for purchasing an FIA. A majority, 55.45%, indicated that they purchased an FIA because of product guarantees. The second most common reason for purchasing was tax deferral, at 54.88%. A minority of customers, 46.60%, indicated that they purchased FIAs with a goal of growth <u>followed by annuitization.</u> A significant number of customers, 40%, indicated that they purchased to transfer assets to their beneficiaries. As such, our data simply does not support the assertion that customers purchase FIAs for the same reason as they would purchase a security.

Second, the Rule Proposal incorrectly states that FIA purchasers are exposed to investment risk:

> Individuals who purchase indexed annuities are exposed to a significant investment risk – i.e., the volatility of the underlying securities index.
>
> (Rule Proposal at page 5.)

This statement mischaracterizes the way in which FIAs work. It also distorts the concept of investment risk. With an FIA, a consumer's contract value will be credited with interest that is based on upward movement in an index but will not be credited negative interest. Interest, once credited, is guaranteed. If a consumer purchases an FIA and the market index decreases 40% over the next year, the consumer's contract value is still equal to the premium paid. (In addition, the contract's minimum nonforfeiture value or surrender value will be at least equal to a stated value plus a guaranteed rate of interest, regardless of any market decrease.) That is because the insurer assumes <u>all</u> of the market risk. If the assets owned by the insurer suffer depreciation or losses, the insurer remains responsible to make good on the guarantees it provides under the FIA. As a case in point, over the last year equity securities investors have suffered double-digit declines in market value, while FIA purchasers have suffered <u>no</u> market-induced loss of principal.

As such, it is simply incorrect for the Rule Proposal to broadly assert that FIA purchasers are at risk or are subject to the volatility of the market. We are not aware of any definition of "investment risk" that would include an annuity where principal is guaranteed, subject to a surrender charge for early withdrawals. There is no such definition in Section 3(a)(8) or in the case law interpreting Section 3(a)(8).

(ii) <u>The Proposed Rule Contains Concepts That Are Outside of and Contrary to Current Supreme Court Precedent</u>

The Rule Proposal appears to adopt a test for determining securities status in which an FIA is a security where any risk is assumed by the consumer, or where the issuer does not assume "enough" risk. For example, the following statements are from the Rule Proposal.

> The individual underwrites the effect of the underlying index's performance on his or her contract investment and **assumes the majority of the investment risk** for the equity-linked returns under the contract.

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> Notably, at the time that such a contract is purchased, the risk for the unknown, unspecified, and fluctuating securities-linked portion of the return is **primarily assumed** by the purchaser.
>
> ****
>
> [T]hese provisions reduce – but do <u>not</u> eliminate – a purchaser's exposure to investment risk under the contract. These contracts may to some extent be insurance, but **that degree may be too small** to make the indexed annuity a contract of insurance.
>
> ****
>
> [T]he protections provided by indexed annuities may not **adequately transfer investment risk** from the purchaser to the insurer when amounts payable by an insurer under the contract are **more likely than not** to exceed the amounts guaranteed under the contract.
>
> ****
>
> The protections offered in these indexed annuities may give the instruments an aspect of insurance, but we do not believe that these protections are **substantial enough.**
>
> ****
>
> (Rule Proposal at pages 6, 25, and 26.)

We believe that the foregoing statements demonstrate a profound misunderstanding both as to how FIAs work and of applicable Supreme Court precedent. As noted above, FIA purchasers are exposed to <u>no</u> downside investment risk; FIA issuers assume the investment risk inherent in an FIA contract.

Moreover, we are not aware of any precedent in Section 3(a)(8) or Supreme Court case law that would apply a test of "majority of the investment risk," "primarily," "adequately transfer investment risk," "more likely than not," or "substantial enough." Section 3(a)(8) does not contain a 70%/30% test or anything resembling such a test. Moreover, even if such a test were to be considered, the test should take into account both upside and downside risk; the Rule Proposal effectively ignores all of the downside investment risk all of which is assumed by the FIA issuer. Based upon existing statutory and case law, if an issuer of an FIA assumes significant investment risk, the FIA is insurance, and not a "security." The Rule Proposal departs materially and in an unprincipled way from existing Supreme Court precedent and is not a reasonable interpretation of Section 3(a)(8).

In the Rule Proposal, the Commission characterizes <u>SEC v. Variable Annuity Life Ins. Co. of Am.</u>, 359 U.S. 65 (1959) ("<u>VALIC</u>"), and <u>SEC v. United Benefit Life Ins. Co.</u>, 387 U.S. 202 (1967) ("<u>United Benefit</u>"), as standing for the proposition that an annuity contract may provide insurance protections but still be characterized as a "security" if the protections are not "substantial enough." This mischaracterizes both decisions. Rather, in these cases the Supreme Court in effect held that an annuity will be treated as a "security" where insurance protections are de minimis or illusory. Given the clear language of Section 3(a)(8), it would have been difficult for the Court to find otherwise.

The following quote from United Benefit more accurately depicts the Supreme Court's holding:

> The record shows that United set its guarantee by analyzing the performance of common stocks during the first half of the 20th Century **and adjusting the guarantee so that it would not have become operable under any prior conditions.**
>
> 387 U.S. at 209 n. 12 (emphasis added).

Similarly, in VALIC the Supreme Court concluded that:

> [T]he concept of "insurance" involves **some** investment risk-taking on the part of the company. The risk of mortality, assumed here, gives these variable annuities an aspect of insurance. Yet it is **apparent, not real; superficial, not substantial**. In hard reality, the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense. . . . For in common understanding "insurance" involves a guarantee that at least **some fraction** of the benefits will be payable in fixed amounts.
>
> 359 U.S. at 71 (emphasis added).

Thus, both of these decisions stand only for the unremarkable proposition that an annuity may be deemed a "security" if its insurance guarantees are "superficial" or in reality non-existent. Neither case supports the Commission's proposed risk test.

(iii) The Rule Proposal Does Not Capture the High Value Many Place on Being Protected from Downside Risk

The Rule Proposal attempts to analyze the concept of risk, and in doing so considers state minimum nonforfeiture protections, but reaches several incorrect conclusions.

State minimum nonforfeiture rules typically require that the guaranteed minimum value of a fixed annuity contract be at least 87.5% of premiums paid, accumulated at an annual interest rate of 1-3% based on the five-year Constant Maturity Rate reported by the Federal Reserve.[1] In discussing this protection, the Rule Proposal accurately notes that at a rate of 1% it would take 13 years for the guaranteed minimum value to equal premium paid. However, the implication that the customer is subjected to "investment risk" is simply inaccurate. Any loss a contract owner might incur as a result of prematurely terminating an FIA contract would not be a reflection of a market loss, but rather would be the functional equivalent of a surrender charge.[2] Indeed, this effectively is how New York defines its nonforfeiture requirement. See NY Ins. Law §4223(c). The existence of a surrender charge, or the functional equivalent of a surrender charge, is irrelevant to the question of whether the product is a "security."

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[1] The actual rate of guaranteed accumulation will rarely be 1%. The declared rate for our FIAs was close to 1% during the periods from late 2003 to May 2004 and from March to July of this year, but more than 2% from December 2005 to October 2007.

[2] FIAs do not assess front end sales charges. Rather, they typically assess a contingent surrender charge. Surrender charges are common to FIAs, traditional fixed annuities and variable annuities. They are designed to cover expenses incurred by an insurer when a contract owner prematurely terminates the contract, to enable the insurer to plan and purchase appropriate investments to cover its contractual obligations, and to ensure that the contracts are being purchased by contract owners solely as a long-term savings vehicle.

Moreover, the insurer is obligated to pay this minimum value regardless of market returns, while simultaneously hedging its obligation to pay index-linked interest credits. If the insurer is unable to earn a return on its own investments (as restricted by state investment rules) sufficient to cover the declared rates of guaranteed accumulation, as well as previously credited excess interest, it may experience a loss on the contract. As such, the insurer assumes significant market risk merely in meeting the state minimum nonforfeiture obligations.

Of course, in addition to nonforfeiture values, FIAs also provide index-linked interest credits, which must be paid regardless of the insurer's investment performance. FIAs typically lock in positive index-linked credited interest, so that contract owners cannot lose previously credited interest due to later market performance. Together, these features provide significant protections to contract owners and allocate meaningful risk to the insurer.

The Rule Proposal asserts that the contract owner takes on significant risk because "at the time that such a contract is purchased, the risk for the unknown, unspecified, and fluctuating securities-linked portion of the return is primarily assumed by the purchaser." (Rule Proposal at page 25.) This effectively defines investment risk solely in terms of the upside uncertainty while ignoring the significant downside risk assumed by the insurer, and ignores the requirements of state minimum nonforfeiture rules. This is contrary to emerging measures of investment risk which focus on an investor's downside risk:

> "[I]t is well known that individuals are more concerned with avoiding loss than with seeking gain. In other words, from a practical standpoint, risk is not symmetrical – it is severely skewed, with the greatest concern going to the downside."
>
> Brian M. Rom and Kathleen W. Ferguson, *Post-Modern Portfolio Theory Comes of Age*, 4th AFIR International Colloquium 349:364. (The full article is provided as Attachment 2).

There are a variety of emerging risk measures which could be applied to measure the investment risk of FIAs and other financial products based on this emerging awareness of the strong value people place on avoiding downside risk. As an example of the potential additional insight that could be gained for consumers by measures that summarize the impact of loss for those wishing to avoid it, we have included Attachment 3 which illustrates various risk measures as applied to FIAs and other types of investments.

We suggest that the Commission thoroughly reevaluate its analysis of the distribution of investment risk between insurers and contract holders, taking full account of the guarantees provided by state minimum nonforfeiture laws, the practice of "locking-in" previously credited interest, and current accepted standards for measuring investment risk.

(iv) <u>The Rule Proposal Does Not Adequately Consider Other, Similar Types of Accumulation Products</u>

Proposed Rule 151A is vague and overly broad and appears to apply to several types of financial products other than FIAs. However, the Rule Proposal contains no discussion of these other products or whether the Commission intends for them to be registered, and does not address the anti-competitive effects of requiring FIAs to register as "securities" if similar, competing products are not subject to registration.

Initially, we note that proposed Rule 151A could be interpreted to apply to traditional fixed annuity products. The test set out in proposed Rule 151A is whether amounts payable under an instrument are calculated by reference to the performance of a security, including a securities index, and whether such amounts are more likely than not to be higher than amounts guaranteed under the instrument. With a traditional fixed annuity, credited rates are set and re-set primarily by reference to current bond rates. As such, excess credited rates on a traditional fixed annuity arguably are set by reference to a security, group of securities or securities index. Further, it is generally expected that excess credited rates on traditional fixed annuities will be higher than the guaranteed rates. As a result, a traditional fixed annuity appears to be a "security" under proposed Rule 151A. Clearly, Congress never intended traditional fixed annuities to be categorized as "securities."

We also note that proposed Rule 151A does not appear to apply to bank index products, even though the logic behind Rule 151A would appear to apply to these products. Proposed Rule 151A initially states that it is applicable to any contract issued by a corporation subject to the supervision of, *inter alia*, a "bank commissioner" of a State; however, the proposed rule ultimately limits its effect to contracts that also are "subject to regulation under the insurance laws of that jurisdiction." Many banks offer index CDs on which interest is linked to securities or commodities indices, together with "principal protection" after some period such as five years. In a briefing book provided to the Commissioners and staff dated September 20, 2006, Allianz included 40 pages of advertisements for these types of products, to highlight the broad range of bank index products available. We do not believe that these competing products have been adequately considered by the Rule Proposal. To the extent that FIAs are required to be registered as "securities" but bank index CDs are not, this provides a significant, unwarranted and unfair competitive advantage to banks and bank products that rely on Section 3(a)(2) of the Securities Act. This disparity in treatment between the banking and insurance industries is an issue that Congress alone should resolve.

(v) <u>The Proposed Rule Does Not Adequately Consider the Protections Provided to FIA Purchasers by State Insurance Laws</u>

In determining whether to adopt Rule 151A in whole or in part, it is critical that the Commission review in detail the protections already available to FIA purchasers under state insurance law. In this regard, we note that while the Rule Proposal refers to the views of various Federal and state securities regulators on proposed Rule 151A (Rule Proposal at page 16), the Rule Proposal does not refer to the views of state insurance administrators. We believe it is a significant oversight in the Commission's rulemaking process not to obtain the views of the regulators primarily responsible for the oversight of insurance products. This is particularly the case given the fact that for purposes of state law FIAs are regulated as fixed insurance (over which the Commission has no jurisdiction) and not as variable insurance (over which the Commission does have some level of jurisdiction). We have previously provided the Commission and its staff a brief analysis of the many ways in which FIAs are substantially more similar to fixed insurance products than securities products. We will not repeat that discussion here but have included this information as Attachment 4 to this letter.

Also, a review of state insurance laws by the Commission would reveal that purchasers of FIAs receive a series of substantial protections under these laws. In some respects, state insurance laws provide better protection to consumers than securities laws. We previously have provided information to the Commission on these issues, included as Attachments 5 and 6, and we will not repeat that information here.

(vi) The Proposed Rule Does Not Adequately Analyze the Effectiveness of Existing State Suitability Standards

The Rule Proposal indicates that the Commission has concerns with sales practices in the FIA industry. However, the Rule Proposal does not cite or provide any objective data supporting these concerns or permitting issuers or marketers to analyze the Commission's assertions or the validity of how the data was compiled. We believe that this is a significant deficiency in the Rule Proposal and suggests that the Commission may be relying on an impressionistic, rather than an empirical, view of sales practices.

The Rule Proposal also fails to address the effectiveness (or even the existence) of developing state insurance law suitability requirements and industry standards. Specifically, the National Association of Insurance Commissioners has created the Suitability in Annuity Transactions Model Regulation ("NAIC Suitability Regulation") to impose an express suitability obligation with respect to annuity sales. The NAIC Suitability Regulation, which the NASD (now FINRA) has supported, has been adopted in most states. The NAIC Suitability Regulation and state insurance law enactments are a recent development which the state insurance commissioners believe will address suitability concerns. We question how the Commission can raise concerns regarding current FIA sales practices when it has not addressed these developing suitability requirements or their effectiveness.

The insurance industry has made many changes to comply with the NAIC Suitability Regulation and state insurance law enactments and to address suitability in annuity sales. For example, Allianz currently conducts a robust suitability review for all FIA business.

- Every proposed FIA transaction in all 50 states (except transactions in which suitability is supervised by a registered broker-dealer) must be submitted with a completed suitability form containing over twenty items of customer information, including age, net worth, monthly income, monthly expenses, monthly disposable income, liquid assets, and source of premium. (A copy of the Allianz FIA suitability form is included as Attachment 7.)

- Every FIA suitability form received by Allianz is processed through an automated suitability review system containing a variety of "triggers" tied to the items of disclosure in the suitability form. Applications that are outside of specified parameters are assessed through a multi-level heightened review process in which the application is individually reviewed and then accepted, modified or rejected.

- In addition, a staff of seven people reaches out by telephone to <u>all</u> customers over age 75 that purchase any of our deferred fixed annuity products to assure that they understand key features of the products.

- Our agents are asked to review and sign the Allianz Code of Best Practices, which outlines our position on three key sales practices: suitability, disclosure, and replacement.

- We partner with LIMRA to send every new customer a third-party survey to assess their purchasing experience. We follow up directly with all consumers who express questions or concerns about their purchase.

In addition, to assist customers in understanding FIAs and determining whether an FIA addresses their needs, we supply them with a simple, plain English disclosure document called a Statement of Understanding ("SOU"). We were the first company to introduce a

SOU nearly seven years ago, and have used an SOU in all transactions in all 50 states since July 2003. Each FIA applicant signs this document, which discloses in detail how the product works, how its value is determined, and the liquidity features of the product. A current form of SOU is included as Attachment 8.

Allianz is proud of its developing suitability process and believes that it is on par with the suitability processes used by many securities firms. We also believe that, whatever historical expertise securities firms may have in reviewing sales of securities and variable annuity contracts, many will have no expertise in reviewing sales of fixed annuity contracts or of the related types of contracts that would be swept into the definition of "security" if Rule 151A is adopted as proposed. Thus, it is questionable whether a new Federal suitability review process for FIAs is necessary or in the best interest of consumers.

2. THE ADOPTION OF PROPOSED RULE 151A WOULD LEAD TO SIGNIFICANT ADDITIONAL COSTS FOR INSURANCE AGENTS, MARKETING ORGANIZATIONS, AND FIA ISSUERS

We believe that the adoption of proposed Rule 151A in its current form would have a significant negative cost effect on insurance agents, marketing organizations, and FIA issuers. Inevitably, these costs and related administrative burdens would negatively affect product cost, product availability, and consumer choice and would have an anti-competitive effect on the FIA industry. We do not believe these important issues have been adequately addressed by the Rule Proposal.

In the FIA industry, there are typically three principal participants in the selling process: the insurance agent, a field marketing organization ("FMO") providing product wholesaling and training services, and the issuing insurance company. If proposed Rule 151A is adopted as proposed, each of these three groups will be required to go to the significant expense and administrative burden of complying with two parallel but completely uncoordinated regulatory regimes. The following discussion outlines the negative effects of proposed Rule 151A on these groups.

a. Rule 151A Represents Duplicative and Overlapping Regulation

It is important to point out that persons in the insurance industry already are subject to the significant costs and administrative burdens of state regulation. To the extent that the securities industry is not subject to these same requirements, the securities industry is given a competitive advantage in terms of lower costs and fewer administrative burdens. The following is a brief list of the types of costs and administrative burdens to which Allianz and other industry participants already are subject.

- Insurance agents are required to obtain insurance licenses (and pay fees) in all applicable states.

- Marketing organizations are required to be licensed as insurance agencies (and perhaps also as third party administrators) in all applicable states.

- Allianz is required to "appoint" agents and agencies with the state insurance departments in nearly all states in which such agents or agencies sell its products and must pay state appointment fees.

- Allianz is required to pay into state guaranty funds in all states for the protection of contract owners.

- Allianz typically pays its FIA customers' premium taxes upon annuitization.
- Allianz (or a subsidiary) is required to become licensed as an insurance company and is subject to compliance requirements and examination by all states.
- Allianz is required to provide statutory financial reporting and audited statutory statements under accounting standards developed by the state insurance regulators.
- Allianz must comply with reserving and other mandated actuarial reporting requirements.
- New products, contracts, and forms must be approved by the state insurance department in each state in which the product is sold.

In total, Allianz paid more than $6.7 million in 2007 for these insurance regulatory costs. This does not include costs associated with staffing our compliance area, or market conduct examinations.

b. Forcing FIA Sales Through Broker-dealers Will Have an Immediate and Potentially Significant Negative Effect on FIA Sales and Consumer Choice

If FIAs become regulated and required to register as "securities," they will have to be sold only by licensed securities registered representatives associated with registered broker-dealers. This could substantially restrict the market for FIAs and reduce consumer choice.

The Rule Proposal suggests that, once FIAs become registered products, broker-dealers may be more likely to carry them as a product line. This seems unlikely. Most broker-dealers already have dozens if not hundreds of product selling agreements "on the shelf." It would be difficult for FIAs to break in, particularly since supporting this new product line would require broker-dealers to become familiar with a new type of product and incur costs of due diligence and new supervisory procedures. In fact, we have seen many broker-dealers already limiting the number of insurance carriers and the number of insurance products that they will carry and dropping variable annuity products for this reason. Consequently, it seems unlikely that these same broker-dealers will now embrace FIAs as a new "security" competing for shelf space.

We also believe that IT/connectivity issues may prevent many broker-dealers from offering FIA products. Many broker-dealers, particularly the larger firms, require electronic connectivity between the broker-dealer and the insurance company because it is too burdensome for these firms to process this business manually. Even where a broker-dealer already offers an insurer's variable annuities, the same insurer's FIA products may use a separate system. At a minimum, addressing these connectivity issues imposes another additional cost on insurance companies. We have projected that our costs to address broker-dealer connectivity requirements could be approximately $2.5 million. This figure does not include the costs that broker-dealers would incur to build out connectivity infrastructure on their end. These IT/connectivity issues obviously represent a significant barrier to entry for FIAs into broker-dealer shelf space.

Even assuming that a broker-dealer that does not currently sell insurance could be convinced to take on FIAs as a product line, the broker-dealer would have to go to considerable expense and delay to be set up to sell the products. The broker-dealer would need to obtain a license as an insurance agency in all applicable states. In addition, some states do not let foreign companies obtain agency licenses, so the broker-dealer would have to set up new insurance agency subsidiaries in those states. The broker-dealer would also need to hire or train insurance compliance personnel, in addition to its existing securities compliance staff.

Further, broker-dealer regulations – and the procedures that are adopted by broker-dealer firms to implement these regulations – are by their nature restrictive and anti-competitive. If FIAs are forced through broker-dealer distribution channels, it can be expected that product availability and consumer choice will be reduced substantially.

- FIA sales agents are generally independent agents who sell products for multiple companies. An agent may be appointed by a half-dozen different companies and sell two to five products offered by each company. This allows the agent to have a wide variety of products to sell to different customers. If the agent becomes a securities registered representative, the agent, in most cases, must be licensed to a single broker-dealer either due to state securities law requirements prohibiting dual registration or the broker-dealer's own policies. The agent will be permitted to sell only products on that broker-dealer's "approved list." As noted above, it is unlikely that broker-dealer approved lists will include as many FIA products as are currently offered, collectively, by the individual agents working independently.

- Many broker-dealers simply do not offer insurance products.

- Many broker-dealers offer proprietary products. These firms may not be willing to open their "approved lists" to competing products such as FIAs.

- Because of a perception that insurance sales by broker-dealers are a "red flag" for audits by Federal securities regulators, some broker-dealers attempt to limit sales of insurance products to a specified percentage of total sales; e.g., 25% of total sales. In these firms, FIAs would be competing with other insurance products for a portion of this artificially restricted percentage.

- If FIA sales are run through broker-dealers, the economics of the transactions will change substantially. Initially, the broker-dealer will take a portion of the sales commission, thereby reducing the sales agent's compensation. In addition, product sales may be skewed toward issuers willing to make various sorts of shelf space payments to the broker-dealers.

All of the foregoing factors can be expected to limit product availability and reduce customer choice.[3]

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[3] We also note that the principal and interest guarantees provided by FIAs are not likely to be adopted in other products. Thus, to the extent that product availability and consumer choice of FIAs diminishes, the availability of these guarantees would be similarly reduced.

For example, FIAs credit positive interest but do not allow negative returns to invade principal or previously credited interest. This type of guarantee can only be made by an insurance product supported by investments held in the insurer's general account. A similar guarantee placed on a variable annuity invested in separate account investment options, for example, would be prohibitively expensive. To support the guarantee, the insurer would have to purchase at-the-money put options each year. As of August 4, 2008, if the variable annuity were invested in an S&P 500 Index fund, the put options would cost $83.43 for every $1,000 invested; assuming a ten-year period at current prices and at the current yield curve, this guarantee would have a present value of $702.59. As a result of the prohibitive cost, this type of guarantee is simply not found in the variable annuity market.

c. Effect of Proposed Rule 151A on Insurance Agents, Including Restrictions on Outside Business Activities

If proposed Rule 151A is adopted in its current form, it will have a substantial and burdensome effect on insurance agents. Agents who may have been selling insurance products for decades will be required to comply with a second, entirely new regulatory regime. Currently, we estimate that approximately 70% of our agents selling FIAs do not hold a securities license. This means that if proposed Rule 151A is adopted, an enormous number of agents would either have to become licensed or leave the FIA industry. We believe the confusion caused by mass licensing and the potential for agents to leave the business – thereby restricting consumer choice – raise significant policy concerns which the Rule Proposal fails to address.

Of greatest concern, insurance agents will become subject to the securities-law outside business activity restrictions in FINRA (NASD) Rules 3030 and 3040. Under Rule 3030, no registered person may receive any compensation from someone other than his/her member firm unless the registered person has provided prompt written notice to the firm. Pursuant to internal procedures, member firms can determine whether or not to permit such activities, and many will not. In addition, under Rule 3040 a member firm must receive detailed information about any "private securities transaction" proposed by a registered person and must pre-approve such transactions if the registered person is receiving selling compensation. Under these rules, the broker-dealer is given the power, in effect, to prevent its registered representatives from engaging in any business other than as a representative. This obviously puts the firm in a conflict-of-interest position in that the firm would generally prefer that the representative conduct only business on which the firm receives compensation (i.e., securities products).

As the Commission may be aware, fixed insurance agents may conduct a variety of businesses in addition to being an insurance agent. For example, they may provide tax or accounting advice, mortgage brokerage, and other types of financial products and services. FIA agents also often engage in a wide variety of other fixed insurance businesses, including sales of traditional fixed annuities, fixed life insurance, long term care insurance, disability insurance, and unregistered group variable annuities sold to qualified plans, as well as the providing of investment advice. As described above, pursuant to FINRA rules, agents would be required to submit all of these businesses to their firm for *de facto* approval or disapproval, which could significantly impact the market for these types of insurance and other financial products. Or, the broker-dealer may approve the business, but attempt to collect a portion of the commissions on these sales, thereby taking away a part of the agent's compensation on non-registered businesses. We believe this raises serious policy concerns not addressed by the Rule Proposal.

Further, if an insurance agent decides to become securities licensed, he or she will become subject to a wide range of other restrictions on his or her activities and will be required to do the following.

- Take and pass the Series 6 securities examination. Note that the Series 6 exam pertains primarily to mutual funds and variable insurance and is largely inapplicable to FIAs, so the examination will not serve an educational function.

- Pay license annual fees. These fees are in addition to the fees already paid to function as an insurance agent. Insurance fees for an annual resident state license range from approximately $90 to $350 per state per agent. If an agent is licensed in all 50 states, he or she would pay approximately $5,200 in annual fees. If FIAs are regulated as securities, these persons will continue paying annual fees for purposes of state insurance laws, but will also have to begin paying securities registration and licensing fees. The representative/agent would pay both FINRA fees (a separate fee is required for each type of securities license) and also state securities fees. A representative/agent selling in all 50 states would pay approximately

$3,100 in initial state securities registration fees and nearly $3,000 annually in ongoing state securities fees.

- Either set up or become associated with a registered broker-dealer.
- Submit all letterhead, business cards, and office signage for broker-dealer approval.
- Obtain errors and omissions coverage (this is required by most firms).
- Have all recommendations approved by a registered principal. The concept of a “registered principal” does not exist in the insurance industry.
- Submit all correspondence, including e-mail correspondence, to the broker-dealer for review.

As noted above, it appears that the principal goal of proposed Rule 151A is to subject FIA sales practices to a Federal suitability requirement. If so, we strongly encourage the Commission to implement that Federal suitability requirement in a manner that is significantly less burdensome than proposed Rule 151A to agents and to the many non-securities markets in which they operate. Rather than require full broker-dealer and registered representative licensure for firms and individuals selling FIAs, we recommend instead that the Commission consider requiring some form of new limited securities license (e.g., Series 6A) for agents who sell no securities except those which are “securities” by virtue of Rule 151A. This new limited securities license would impose agent education and examination requirements which are tailored to FIA sales activity and would substantially reduce, if not eliminate, the ancillary requirements (such as outside business activities limitations, general broker-dealer supervision and certain fee requirements) imposed upon registered representatives generally.

d. Effect of Proposed Rule 151A on Field Marketing Organizations (FMOs)

Proposed Rule 151A would also have significant effects on FIA field marketing organizations.

In some cases, FMOs are registered as broker-dealers, or are associated with a broker-dealer. In many cases, they are not. If proposed Rule 151A is adopted as drafted, an FMO not currently registered as a broker-dealer would need to register as such to continue its activities and be paid commissions. If it does not register, it will no longer be able to receive commissions and will no longer be allowed to sell FIAs.

If an FMO chooses to continue with its existing business model, it will need to register as a broker-dealer, and it will be subjected to a number of new requirements listed below. The cost and burden of these requirements is significant, and just the legal and regulatory work of the initial setup, licensing, and staffing for a new broker-dealer could easily cost between $250,000 and $500,000.

- The FMO will need to register with the Commission as a broker-dealer, in addition to maintaining its registration as an insurance agency with state insurance commissions. As noted above, the initial setup costs for a new broker-dealer could be $250,000 or more. In addition, the new broker-dealer would be required to pay first-year state securities fees of $12,705 (assuming registration in 50 states), and ongoing fees of $11,650. The new firm would also be required to pay approximately $26,000 in the first year to qualify as a foreign corporation in all states, including publication of notices, appointments of agents for process, and so on, and ongoing annual fees of approximately $4,000.
- It will need to become a member firm of FINRA and pay FINRA fee assessments.

- It will need to develop extensive written policies and procedures tailored to its business. (This will be in addition to the "Compliance Guide" or "Operational Rules" that typically will already have been adopted by the issuing insurance company.)

- It will need to obtain a fidelity bond, in addition to maintaining bonding requirements (e.g., surety bonds) imposed by state insurance law.

- It will need to register its offices as branch offices. (There will be a separate fee for each branch.) The concept of a "branch office" does not exist in the insurance industry. It will need to conduct regular examinations of all branch offices. It will need to staff many branch offices with registered securities principals. The concept of a "registered securities principal" does not exist in the insurance industry. (There will be a separate license fee for each principal's license. Because each principal will hold two or more licenses, multiple license fees will be paid for each principal.)

- It will need to hire or train securities compliance personnel, in addition to maintaining its insurance compliance personnel. It will need to retain a qualified "chief compliance officer" who has taken and passed the applicable principals' exam. The concept of a "chief compliance officer" – defined by the securities laws as requiring specific qualifications and completion of a specified test – does not exist in the insurance industry.

- It will need to hire a trained Financial Operations Principal, or "FINOP" who has taken the requisite principals' examination. The concept of a FINOP does not exist in the insurance industry.

- It will need to set up a procedure for a principal review of all applications, as well as review of advertisements, business cards, letterhead, office signage, correspondence, and e-mails. It can be expected that acquiring e-mail tracking software and storage hardware will be a significant expense.

These requirements, in the aggregate, will impose a significant cost burden on the FMO. We believe these burdens, which may force many FMOs out of business, have not been adequately analyzed by the Rule Proposal.

e. Effect of Proposed Rule 151A on Issuers

Proposed Rule 151A, if adopted as proposed, will also impose significant burdens on FIA issuers, including Allianz.

(i) Additional Filing Fees

In addition to fees and assessments already paid to insurance regulatory authorities, an issuer of registered FIAs will also have to pay SEC registration fees. Assuming sales of $5 billion annually, Allianz will be required to pay $196,500 in securities filing fees.

(ii) "Super" Net Capital Requirements

If FIAs become registered products, Allianz will be required to sell its products through broker-dealers. One possible sales structure would be to distribute its FIAs through its broker-dealer subsidiary, Allianz Life Financial Services, LLC ("ALFS"). ALFS currently acts as distributor for all of Allianz' variable insurance products. ALFS functions only as a wholesale broker-dealer, and does not effect retail sales. Retail sales are effected by third-party firms. If FIAs are sold through ALFS, there will be a special, "super" net capital requirement imposed on the transaction. ALFS has been advised by FINRA and

Commission staff that broker-dealers selling insurance products are subject to substantially higher net capital requirements than broker-dealers selling mutual funds, creating, in effect, a super net capital requirement for broker-dealers selling insurance products. See Exchange Act Rule 15c3-1(c)(2)(iv)(C). As a result of this interpretation, ALFS – which is a "minimum net capital" broker-dealer – must maintain required minimum net capital of more than $16.5 million (as of June 30, 2008). A broker-dealer for a registered mutual fund selling a similar volume of business would be required to maintain only about $170,265 in net capital, or approximately 99% less. While this may vary depending upon various factors, Allianz estimates, based upon sales of $5 billion of FIAs per year, that Allianz may need to contribute up to an additional $50 million of capital to ALFS if FIAs are categorized as securities and sold through ALFS.

If Allianz is required to contribute additional capital to ALFS, most of the capital would be invested in low-yielding Treasury securities (yielding perhaps 4-5%) to assure that the capital contributed is assessed the minimum "haircut" possible. This is substantially below Allianz' "cost of capital" from its parent company. Moreover, Allianz will be unable to count the majority of its investment in ALFS as capital. Pursuant to rating agency requirements applied to Allianz, up to 70% of the Company's investment in its subsidiary will be disallowed. In other words, if Allianz contributes $50 million of capital to ALFS, it will only be able to count $15 million as capital. This significant cost to insurance company issuers has not been addressed in the Rule Proposal.

(iii) Costs of Registration and Prospectus Printing

The Rule Proposal grossly understates the costs of registering FIA products. The Rule Proposal indicates that, if proposed Rule 151A is adopted in its current form, FIAs likely will be registered on Form S-1. We believe that the use of this form will lead to significant unnecessary costs.

Form S-1 is a cumbersome form that was not designed for insurance products. Form S-1 requires the disclosure of a large amount of irrelevant information, including a variety of information that is not prepared by many insurance companies. For example, the form will require the inclusion of GAAP financial statements often not prepared by insurance companies other than in the SEC registration context. Unlike Forms N-4 and N-6, Form S-1 does not provide insurers with the ability to include statutory (rather than GAAP) financial statements in a registration statement if they would not otherwise be required to prepare GAAP financial statements. Many insurance companies only prepare and file statutory financial statements prepared in accordance with state insurance laws. If FIAs are required to be registered, these insurance company issuers would then be required to prepare two different sets of financial statements, GAAP and statutory. (To support the new GAAP financial statements, issuers would be required to retain additional internal and external accounting and audit resources, at a significant additional cost).

The financial information required to be included in a Form S-1 registration statement is also more extensive than that required by Forms N-4 and N-6 (e.g., selected financial data for the prior five fiscal years). Moreover, Form S-1 requires full financial statements to be included in the printed prospectus (whereas mutual funds and variable products may include financial statements in a part of the registration statement that is not printed), resulting in substantial additional printing and mailing costs. Allianz' most recent financial statements are over 50 pages long.[4] As a result, a prospectus filed on Form S-1 may be 50-

[4] Allianz prepares some GAAP financial statements for purposes of financial reporting to its parent, Allianz SE, which is traded on the New York Stock Exchange.

100% longer than a mutual fund prospectus filed on Form N-1A. This obviously leads to cost and marketing disadvantages for FIA issuers, without any obvious benefit to the consumer.

In addition, Form S-1 requires a registrant to prepare a Management's Discussion and Analysis and an extensive disclosure of executive compensation (neither of which is typically prepared for other purposes by insurance companies). Undertaking the necessary due diligence to draft and finalize disclosure on these items can take several weeks, if not months, and requires a significant amount of resources.

Moreover, the registrant will incur significant legal costs and expenses in preparing the Form S-1. Initially, many insurance companies will not have qualified internal securities counsel, and these persons will have to be hired. In addition, insurers will incur significant costs for external counsel – costs which will vary considerably depending upon whether the issuer has previously prepared a Form S-1 registration statement. If it has, we would estimate external legal costs at $50,000-100,000. (Of course this cost is per registration statement, and would be increased for additional registration statements. Unlike mutual fund registrants, insurance company registrants cannot file in "series" format, and so would have to file a separate registration statement for each registered product.) For registrants that have not previously prepared a Form S-1 registration statement, external legal costs would be much higher, possibly $250,000-500,000.

Based on all of these factors, we believe that the Rule Proposal significantly understates the costs of registering FIAs.

With regard to prospectus printing, the Rule Proposal indicates that the Commission believes that the cost of preparing and printing an FIA prospectus filed on Form S-1 should be roughly equivalent to preparing and printing a mutual fund prospectus filed on Form N-1A. See Rule Proposal page 77 and footnote 118. This is overly optimistic. Based upon our internal projection of prospectus printing and mailing costs, an FIA prospectus would cost twice as much as a mutual fund prospectus, as follows.

> Assume a standalone mutual fund prospectus with an average approximate page count of 25 pages and an S-1 FIA prospectus with an average approximate page count of 100 pages (including financial statements), 27# paper weight, a four-page cover, and a print quantity of approximately 3,000 prospectuses. (The per piece print cost would decrease significantly as the quantity increases.)

	Estimated Print Cost For Each Prospectus	Estimated Mail Cost For Each Prospectus	Total Cost For Each Prospectus
S-1 Prospectus	$1.50	$1.38	$2.88
Mutual Fund Prospectus	$ .69	$ .86	$1.55
Difference / Prospectus	$ .81	$ .52	$1.33

Currently, Allianz uses a simple, ten-page disclosure form for its FIAs called an SOU. A copy of Allianz' form of SOU has previously been provided both to the Commission and to FINRA. A current form of SOU is included as Attachment 8 to this letter. If Allianz is required to prepare a bulky 100-page Form S-1 prospectus for each of its FIAs, it will increase costs significantly over current disclosure costs. And, we believe, it will provide disclosure to its customers that is more confusing and harder to understand than the disclosure in the SOU.

In addition to financial printing costs, the concept of EDGAR electronic filing does not exist in the insurance industry. Consequently, an insurance company registering FIAs would need to incur significant costs to build or purchase the capabilities for SEC electronic filing or retain a third-party service provider to do so on its behalf.

(iv) Costs Associated with Discontinued or Disrupted Sales and Development of New Products

To avoid the significant costs and burdens associated with registering existing FIAs, certain insurers may instead cease offering such products or reduce the number of available products. This likely would result in collateral costs to the insurer (e.g., the loss of personnel who are no longer needed to administer the products) as well as to third-party service providers who helped support the administration and/or sale of the insurer's FIAs. These costs would be in addition to the lost revenue and diminished competition costs noted by the Commission in the Rule Proposal.

Insurance company issuers which register one or more of their existing FIAs may have to interrupt sales of those FIAs while the registration statement is pending to ensure that all sales are effected in compliance with the Securities Act. Alternatively, such issuers may decide to develop and register new FIAs to avoid such concerns. The time and costs involved with developing, marketing, and selling a new product are considerable, and would include significant internal and external resources to develop the product and obtain necessary state insurance regulatory approvals.

(v) FINRA Fee Assessments

If FIAs are required to be registered as securities, the products will become subject to FINRA's jurisdiction and FINRA fee assessment. Based upon $5 billion of annual sales, Allianz' broker-dealer subsidiary, ALFS, will be required to pay an additional $200,000 in annual FINRA fees. In addition, FINRA fees "double dip" where products are sold through both a wholesale and a retail broker-dealer. As such, in addition to the $200,000 that would be paid in fees by the Allianz wholesaler ALFS, an additional $200,000 would be paid by the selling retail firms. This significant cost has not been considered in the Rule Proposal.

We have not reviewed in depth all of the Rule Proposal's estimations of costs. However, the Commission's assumptions regarding cost estimates appear to be materially incomplete, and we believe they should be closely reviewed and reconsidered.

3. PROPOSED RULE 151A DOES NOT PROVIDE ADEQUATE CLARITY FOR THE REGULATION OF FIAS

Proposed Rule 151A represents only a relatively small first step in the regulation of FIA products. The proposed rule does not attempt to comprehensively address the mechanics of regulating FIAs. For example, proposed Rule 151A is not accompanied by any registration form for FIAs, and it is not accompanied by any specialized filing rules. In practice, this means that FIA issuers will be forced to use forms and rules designed for conventional corporate financing transactions (i.e., Form S-1), which will be burdensome and unnecessarily expensive. These additional burdens and costs will have an anticompetitive effect on the FIA industry. For this reason, we believe that proposed Rule 151A as currently proposed is seriously deficient.

We note that, in the past, it has taken considerable periods of time for the Commission to generate the requisite forms and rules to regulate registered insurance products. For example, after the Supreme Court in the VALIC case held that variable annuities with minimal guarantees are securities, it took more than 25 years for the Commission to approve a registration form designed for variable annuities. Similarly, after the Commission in its Red Book study of the investment company industry in 1992 identified the absence of a registration form for variable life products as one of the larger gaps in investment company regulation (Protecting Investors: A Half Century of Investment Company Regulation at 408), it took the Commission a full decade to adopt Form N-6 for variable life products. In the context of proposed Rule 151A, we believe it would be inappropriate for the Commission to cause FIA issuers to suffer another "lost decade" of cumbersome, inapplicable forms and rules after the adoption of the proposed rule. While we do not believe that proposed Rule 151A should be adopted, if it is, we believe that the adoption of the proposed Rule should be accompanied by all required forms and rules, as outlined in the following discussion.

a. Form S-1 Is Not an Appropriate Form for Registration of FIAs

Form S-1 was not designed for insurance products, and it would provide poor, difficult-to-follow disclosure for annuity consumers. We believe that use of a prospectus filed on Form S-1 would be a substantial step backward for Allianz and its customers, as disclosure contained in the SOUs currently used by the Company is simpler, clearer and easier for the consumer to understand. Moreover, we request that the Commission take notice of the fact that Allianz is regularly informed by a number of other regulators that they do not like the use of prospectuses in insurance transactions, that "no one reads the prospectus," and that prospectuses generally provide poor disclosure that is not consumer friendly. We also request that the Commission take note of the fact that its staff has been encouraging industry efforts to develop a short-form prospectus for variable annuity sales. Thus, requiring the cumbersome Form S-1 for FIA registration would seem to be a significant step in the wrong direction.

If a new form for registration of FIAs is not generated contemporaneously with any adoption of proposed Rule 151A, we recommend that the Commission adopt simplifying amendments to Form S-1 for FIA products. In June of 2006, Allianz presented the Commission's staff with a no-action proposal for simplifying Form S-1 disclosure for insurance company registrants. A copy of that letter is included as Attachment 9 to this letter. When this letter was filed, the Commission's staff indicated that it did not want to address changes of this magnitude in a no-action letter, but rather rulemaking would be required. In the context of the rulemaking involved in adopting proposed Rule 151A, we request that the Commission reconsider our request for simplifications to Form S-1.

In the event that the Commission determines to require the use of Form S-1 without any simplifications, we believe the Commission should further consider the issue of the subsequent use of Form S-3 by FIA issuers. In the Rule Proposal the Commission indicates that, if proposed Rule 12h-7 exempting FIA issuers from Exchange Act periodic reporting requirements is adopted, FIA issuers registering on Form S-1 would never be eligible to use the simpler Form S-3, because use of that form is predicated on the issuer being an Exchange Act filer. (Rule Proposal at pages 61 and 62 and footnote 99.) We recommend that Form S-3 be made available to FIA issuers that are not Exchange Act filers where the issuers file additional information designated by the Commission as an exhibit to their Form S-3 registration statement, and incorporate that information by reference into the prospectus.

In the alternative, we would strongly support the use of the somewhat more applicable Form N-4 for registration of FIA products. (See Rule Proposal at page 30.)

b. Simplifying Rules

The Commission should adopt a series of simplifying and streamlining rules along with any adoption of proposed Rule 151A. In the absence of these rules, the Commission will increase costs incurred by FIA issuers significantly and unnecessarily and will make these issuers less competitive relative to issuers of variable annuities and mutual funds, and this will result in more burdens and costs to individuals purchasing FIAs.

- **Rule 485 under the Securities Act.** Rule 485(b) provides a simplified process for filing an amended registration statement containing no material changes without review by the Commission's staff. This rule provides a valuable tool for registrants and the staff to avoid the costs and burdens of unnecessary reviews of registration statements. However, Rule 485 does not apply to insurance companies registering on Form S-1. We recommend that the benefits of this rule be extended to Form S-1 registrants that are registering insurance products.

- **Rule 24f-2 under the Investment Company Act.** Rule 24f-2 provides a simplified process for calculating and paying filing fees to the Commission. The Rule permits a registrant to pay fees annually in arrears, rather than guessing as to sales at the beginning of the year. If an issuer cannot rely on Rule 24f-2, the issuer must develop costly monitoring systems to oversee the sale of its securities and ensure it does not sell more than the amount it registered. In addition, because investment companies are always issuing and redeeming shares, Rule 24f-2 permits the registrant, in calculating fees, to net redemptions against sales. The financial benefit of netting redemptions against sales can be significant. For example, in 2007, Allianz variable insurance products had net redemptions of $2.18 billion. This resulted in a fee savings of $82,530. If FIAs are required to be registered as securities, we project that, once Allianz' FIA business is established as a registered business, it will pay over $100,000 annually in excess registration fees as a result of the inability to net redemptions against sales. We recommend that Rule 24f-2 be extended to Form S-1 registrants that are registering insurance products.

- **Rule 482 under the Securities Act.** Rule 482 provides a flexible rule for the use of sales literature that is not accompanied or preceded by a prospectus. This rule is only available to investment companies. If the rule cannot be used by FIA issuers, they would have to rely on the much more restrictive and cumbersome Rule 134 or 135 to disseminate sales literature that is not accompanied or preceded by a prospectus. This restriction would give a significant advantage to mutual funds and variable annuity issuers. We recommend that Rule 482 or a similar rule be made available to FIA issuers.

- **Rule 146 under the Securities Act.** We were surprised to see that the Rule Proposal apparently did not consider the interrelationship between proposed Rule 151A and Section 18 of the Securities Act. Section 18 of the Securities Act is part of the National Securities Markets Improvements Act of 1996, or "NSMIA." In effect, NSMIA reflects a Congressional determination that broad classes of securities and insurance, including investment company securities and insurance products excluded from the Securities Act pursuant to Section 3(a)(8), should be exempted from overlapping and conflicting state regulation. However, Section 18 does not clearly address FIAs or other non-variable registered insurance products. If FIAs had existed in 1996, there is no question they would have been expressly covered by NSMIA.

  There are numerous state statutes that, in effect, pre-empt state securities regulation of insurance products, and vest exclusive jurisdiction over insurance products in state insurance departments. However, we believe that this is an issue that should be addressed comprehensively as a matter of Federal law.

  We recommend that Rule 146 be amended to expressly state that, for the limited purpose of Section 18 of the Securities Act, an insurance company registering an annuity product is deemed to be an investment company. We believe it is appropriate to treat an insurance company as an investment company for limited purposes. In this regard, we note that, but for an exclusion in Section 3(c)(3) of the Investment Company Act, insurance companies would generally be treated as investment companies pursuant to that Act. Similarly, FINRA categorizes insurance companies as investment companies for some purposes. See FINRA (NASD) Rules 1032(b)(1)(A) and 1022(d)(1)(A)(iii).

- **FINRA (NASD) Rule 2710**. FINRA (NASD) Rule 2710 requires, among other things, the filing of certain information and documents with FINRA and regulates the compensation that can be paid in connection with a securities offering. Variable contracts and modified guaranteed insurance products are exempt from Rule 2710, and we recommend that the offering of FIAs be exempt from this rule as well.

- **Rule 15c3-1(c)(2)(iv)(C**). As discussed above on page 17, broker-dealers selling insurance products are subject to "super" net capital requirements significantly in excess of capital requirements of broker-dealers selling mutual fund shares and other investment company products. We believe this is unwarranted and discriminatory, and recommend that, for the limited purpose of Rule 15c3-1(c)(2)(iv)(C), insurance company issuers registering insurance products should be deemed to be "investment companies."

4. OTHER MATTERS

In response to the Commission's request for comment on other matters, we provide the following additional comments:

- As stated above, we strongly endorse the principal concepts underlying proposed Rule 12h-7. We believe, however, that the provisions of the proposed rule restricting assignment and transferability may be unworkable and should be revised or eliminated.

- If the Commission elects to require that FIAs be registered as securities, we recommend that the Commission adopt a new registration form tailored specifically to FIAs prior to the effective date of any final Rule 151A. If an FIA-specific form is not adopted, we recommend alternatively that the Commission authorize the use of Form N-4 by FIA issuers or that the Commission simplify Form S-1 for FIA issuers.

- We do not believe the proposed rule should be extended to fixed index life insurance products. Fixed index life insurance products feature a clear and substantial element of mortality risk assumed by the insurer. These products are well within the exclusion for insurance policies in Section 3(a)(8) of the Securities Act and cannot reasonably be construed to be "securities."

CONCLUSION

Based on the foregoing, we request that the Commission comprehensively review the Rule Proposal and its associated burdens as outlined in this letter before proceeding further.

Once again, we thank the Commission for this opportunity to provide our comments on the Rule Proposal. As outlined in this letter, we do not believe that it is necessary or appropriate to classify FIAs as securities. These products are insurance and should be regulated as such. A re-categorization of these products as securities would have significant, wide-ranging, and negative ramifications that the Commission simply has not considered. In addition, we believe that industry sales practices already have evolved substantially over the last few years and that many of the concerns raised by the Commission, including suitability, already have been addressed by state regulators and the industry. Finally, we believe that it is neither necessary nor good public policy to require securities licensure for agents selling FIAs. FIA licensure should be limited and tailored to FIA sales.

Sincerely yours,

Stewart Gregg

Stewart D. Gregg,

Managing Senior Securities Counsel

cc: Chairman Christopher Cox
Commissioner Kathleen L. Casey
Commissioner Elisse B. Walter
Commissioner Luis A. Aguilar
Commission Troy A. Paredes
Brian G. Cartwright, General Counsel
Andrew N. Vollmer, Deputy General Counsel

ATTACHMENT 1

This material is taken from a letter to Mr.Keith Carpenter, Senior Special Counsel, Division of Investment Management of the Securities and Exchange Commission, dated September 7, 2005. This letter was in response to the Commission's 2005 inquiry regarding FIAs.

X. LEGAL BASIS FOR RELYING ON SECURITIES ACT SECTION 3(a)(8)

The Company believes that its EIA products qualify as "insurance" within the meaning of Section 3(a)(8) of the Securities Act of 1933. In determining that the EIA products qualify for the exclusion from the Federal securities laws set forth in Section 3(a)(8), the Company has focused on the three key factors consistently reviewed by the Federal courts and the Commission under a Section 3(a)(8) analysis: (1) the allocation of investment risk under the EIA products is on the Company; (2) the Company's assumption of a meaningful mortality risk under the EIA products, and (3) the marketing of EIA products primarily as insurance rather than as investments.

A. Overview of Section 3(a)(8) as Applied to EIA Products

Section 3(a)(8) provides that "Any...annuity contract...issued by a corporation subject to supervision of the insurance commissioner... of any State..." is excluded from the definition of "security." The Company's EIA products clearly meet the technical reading of this provision, in that the EIAs are:

- Annuity contracts filed with and approved by all applicable state insurance departments.
- Issued by a corporation.
- Subject to the supervision of a state insurance commissioner.

The exclusion in Section 3(a)(8) is premised in significant part on the fact that insurance products are subject to comprehensive regulation at the state level. And in this regard, EIAs are virtually indistinguishable from traditional fixed annuities, in that:

- EIAs are issued by insurance companies licensed in each jurisdiction in which the products are offered.

- EIA contracts are required to be reviewed and approved by the domicile state and each state in which the contracts are offered.

- EIAs issuers are required to meet capital requirements that are identical to those for issuers of traditional fixed annuities.

- EIA issuers are subject to regular examination by their domiciliary state and other states in which they offer products.

- EIA issuers must file extensive annual financial information with state regulatory authorities.

- EIAs, like other fixed annuities, are backed by all general account assets, and not just the assets of a separate account.

- EIAs, like other fixed annuities, must invest general account assets in accordance with state "permitted investment" laws.

- EIAs, like other fixed annuities, must meet minimum nonforfeiture requirements.

- EIAs are subject to specialized consumer disclosure laws, including contract "readability" requirements and specialized disclosures on exchanges.

- EIA purchasers receive the benefit of a consumer protection "cooling off period" in the form of a 10-day free look right. Additional free look rights may be provided to certain persons, such as seniors. In California, seniors have the benefit of a 60-day free look right.

The Company recognizes that United States Supreme Court opinions subsequent to the enactment of Section 3(a)(8) take the position that, in certain extreme cases, annuity contracts such as variable annuities that shift substantially all risk to contract owners may not constitute "insurance" for purposes of Federal law and so may be "securities" not covered by the 3(a)(8) exclusion. The Company believes, however, that its EIAs are easily distinguishable from the annuities at issue in these cases. The Company believes that the following additional factors are pivotal to the determination that the Company's EIAs are insurance and meet the requirements of Section 3(a)(8).

- The Company accepts substantial financial risk with regard to its EIAs.

- The Company's crediting guarantees are not a pass-through of general account performance.
- The caps on excess credited index interest are established in advance for a period of at least one year, and are not subject to modification by the Company.
- The Company guarantees a minimum non-indexed fixed interest rate in accordance with state nonforfeiture law.
- The Company guarantees the participation rate and a minimum indexed interest crediting cap for the life of the contract.
- The minimum accumulation value for the Company's EIAs meet the requirements of state nonforfeiture laws.
- The Company is subject to lapse risk and annuitization risk and the risk of over utilization of liquidity rights.
- The Company is subject to mortality risk.
- The Company markets its EIAs as insurance products.

B. The Company Assumes Significant Investment Risk On Its EIA Products

The Company assumes significant investment risks on its EIA products. These risks include the risk the Company assumes by being contractually obligated to apply index interest credits under the EIA products regardless of the investment experience of its general account assets. They also include the substantial minimum nonforfeiture guarantees made by the Company on its EIA products. The Company believes that the risks outlined in Sections V (at page 12) of this letter clearly demonstrate assumption of investment risk sufficient to meet the requirements of Section 3(a)(8). The Company also believes that its assumption of significant investment risk results in substantial compliance with Rule 151's investment risk standard.

3. <u>The Company's EIA Products Substantially Comply With the Investment Risk Test in Rule 151</u>

It is the Company's position that its EIA. products substantially comply with Rule 151's investment risk conditions.

(a) No Sharing in the Investment Experience of a Separate Account

The first prong of Rule 151's investment risk test requires that the value of a contract must not vary according to the investment experience of a separate account.

The values of the Company's EIA contracts do not vary according to the investment experience of a separate account or of the Company's general account. Rather, the EIA. Contract provisions provide certain absolute guarantees by the Company, regardless of portfolio performance. In addition, all of the assets in the Company's general account remain available to meet the guarantees provided under the EIA products, and not just a segment of the assets or the assets of a separate account. Moreover, the general account assets of the Company are subject to the various quantitative and qualitative restrictions on insurance company general account investments that are imposed under state insurance law.

Thus, in accordance with Rule 151, the values of the EIA contracts do not vary according to the investment experience of a separate account.

(b) Guarantee of Principal and Previously Credited Interest

The second investment risk condition of Rule 151 is that for the life of the contract, the insurer must guarantee the principal amount of premiums and interest credited thereto (less deductions, without regard to timing, for sales, administrative or other expenses or charges).

The EIAs guarantee an accumulation value equal to net premium,[25] plus premium bonus (if applicable) and previously credited interest. Once excess interest is locked in it cannot be lost as a result of index movements (the index interest crediting mechanism ensures that an annual index credit will never be less than zero). Thus, the accumulation value guarantees net premium[26] (which effectively guarantees principal), and an annual index credit that will never be less than zero (thus effectively guaranteeing previously credited interest).

The EIA products also guarantee that in the event of a full surrender or non-standard annuitization,[27] the contract owner will receive at least the GMV[28]. The GMV is equal to:

- 87.5% of premiums (this figure may be different in some states that have not adopted the new standard nonforfeiture law),

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[25] Net premiums means all premiums less any withdrawals of credits, surrenders (including any surrender charges and/or partial MVAs), and loans.

[26] Net premiums means all premiums less any withdrawals of credits, surrenders (including any surrender charges and/or partial MVAs), and loans.

[27] Standard annuitization occurs if the contract has been in deferral for at least five years, and the contract owner elects annuity payments either for life, or over at least ten years (if annuity Option D is elected under a single-tier product, payments may be made for only five years). An annuitization that does not meet these conditions is considered to be a non-standard annuitization, under which only the cash value will be applied to annuity payments. Under InCommandDex annuity payments are available immediately and the only available annuity options involve lifetime payouts, therefore, only standard annuitization is available on this product.

[28] The Company notes that while the GMV is a requirement imposed by state insurance nonforfeiture laws that is contained in all fixed annuity products, it is not the sole guarantee that should be taken into consideration for purposes of a Section 3(a)(8) analysis.

- plus GMV interest;
- less prior partial surrenders (and any associated surrender charges and/or partial MVAs[29]);
- less loans, and
- less prior systematic withdrawal of credits.[30]

Under four of the Company's EIA products, the Company assesses an MVA during the surrender charge period on surrenders, non-standard annuitization, and/or a lump sum payment of the death benefit. The application of the MVA is such that it could increase or decrease the amount surrendered, annuitized, or paid out. However, even assuming the maximum possible market movement and related MVA, the MVA is subject to a substantial floor that results in significant investment risks being assumed by the Company even when the MVA is assessed.

The SEC indicated in the release adopting Rule 151 that contracts with MVA features do not technically qualify for the safe harbor of Rule 151. However, the SEC also noted that an MVA that "merely requires forfeiture of a small portion of previously credited interest" is less problematic than an MVA that "invades principal" [31] Here, the limited MVA feature of the EIA contracts provided by the nonforfeiture floor more closely approximates a feature that "merely requires forfeiture of a small portion of previously credited interest,[32] than a feature that "invades principal." Moreover, it should be noted that the MVA only applies during the surrender charge period (which ranges from seven years to ten years);[33] the MVA does not apply after the surrender charge period expires. The MVA is also not assessed under the free withdrawal provision, standard annuitization, systematic withdrawal of credits, or for withdrawals made to cover certain medical emergencies that require extended hospital, nursing home, or long-term care facility stays.

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[29] The New York MasterDex, MasterDex 10, PowerDex Elite series, BonusDex Elite, FlexDex Multi-Choice Elite, SelectDex Multi-Choice, and InCommandDex contracts do not impose an MVA.

[30] The SelectDex Multi-Choice, PremierDex, PremierDex 5, and InCommandDex contracts do not offer systematic withdrawal of credits, thus none are deducted from the GMV.

[31] Release 6645 at n. 14-16 and accompanying text.

[32] Id

[33] For PowerDex Elite and 5% Bonus PowerDex Elite the MVA does not apply during the first contract year.

In sum, the Company guarantees minimum nonforfeiture values for the life of each EIA product equal to 87.5% of net premiums[34] and interest credited thereto (less deductions, without regard to timing, for sales, administrative or other expenses or charges).

(c) Guaranteed Interest Rate

Rule 151 also requires that for the life of the contract, the insurer must credit net premiums, as well as interest credited to such net premiums, with a specified rate of interest at least equal to the minimum rate required to be credited by the relevant nonforfeiture law in the jurisdiction in which the contract is issued (or if no such law is applicable, the rate required for individual annuity contracts by the Standard Nonforfeiture Law of the National Association of Insurance Commissioners (the "NAIC").

For the life of each EIA product, the Company guarantees (in substantially all states) that it will credit 87.5% of net premiums[35] with interest at a rate at least equal to the minimum specified interest rate required by the relevant state nonforfeiture law for individual deferred annuities in the jurisdiction in which each EIA contract is issued. If that jurisdiction does not have an applicable nonforfeiture law at the time the EIA contract is issued, the specified rated under the EIA contract will be at least equal to the minimum rate required for individual annuity contracts by the Standard Nonforfeiture Law adopted by the NAIC.

Furthermore, the effective annual interest rate under the GMV is guaranteed for the life of the EIA contract, unlike the contract in Peoria Union Stock Yards Co. v. Penn Mutual Life Insurance Company ("Peoria Union").[36] In Peoria Union the court determined that the insurer did not assume sufficient investment risk to be entitled to rely on the Section 3(a)(8) exclusion when the insurer failed to provide any guarantee of interest under the annuity contract after the third contract year.[37] The guarantee of a permanent interest rate over the life of the EIA Contract reflects a significant assumption of investment risk by the Company. While the current NAIC Standard Nonforfeiture Law for Individual Annuities permits nonforfeiture rates to be changed at designated intervals, the guaranteed minimum interest rate reflected in the GMV in an issued an outstanding contract is permanent and cannot be redetermined during the life of the contract.

Thus, the Company believes the specified rate of interest guaranteed through the operation of the GMV substantially complies with the third investment risk condition of Rule 151.

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[34] Net premiums means all premiums less any withdrawals of credits, surrenders (including any surrender charges and/or partial MVAs), and loans.

[35] This figure may be different in some states that have not adopted the new standard nonforfeiture law.

[36] 698 F.2d 320 (7th Cir. 1983).

[37] Id. at 324-325.

(d) One-Year Interest Rate Guarantee

The fourth investment risk condition of Rule 151 requires that the insurer guarantee that the rate of any discretionary excess interest to be credited will not be modified more frequently than once per year.

The Company assumes significant investment risk in the manner in which it credits interest under the Contracts. The crediting of excess non-indexed interest in advance for a one-year period is consistent with Rule 151. In addition, the crediting of indexed excess interest based upon pre-declared participation rates and caps in the fashion contemplated by the EIA products locks the issuer into a pre-declared rate cap for one year, and does not result in contract owners assuming investment risk sufficient to take the EIA. products outside Rule 151 and Section 3(a)(8). The index[38], the formula for determining the indexed interest credited, the date on which the index interest credit is calculated and locked in, the minimum on the index interest cap, and the participation rate are all determined at the time the EIA contract is issued and cannot be later changed. The index is an objective index beyond the Company's control, and is independent of the Company's investment experience. The Company has discretion only to change the cap that determines the maximum index interest credit at the beginning of each index term. The actual cap to be used in calculating index interest credits is declared in advance for periods of at least one-year duration and cannot be changed once declared, consistent with the minimum one-year concept set forth in Rule 151.

Moreover, the Company guarantees that once locked in, excess interest cannot be lost as a result of index movements. The Company thus bears the significant investment risk that the return on its own invested assets will not be at least equal to the excess interest determined under the independent index feature. Thus, the Company bears the substantial investment risk of paying out the index interest credit - calculated pursuant to a formula fixed in advance in the EIA contracts by reference to an external index that the Company does not control - even if the Company's investments do not perform at a rate equal to the index feature. While the Company may take steps to manage this investment risk, as discussed previously, such steps are akin to other risk management techniques utilized by the Company with respect to more traditional excess interest products and such steps do not, in the final analysis, eliminate the Company's investment risk or shift investment risk to contract owners.

In Rothwell v. Chubb Life Ins. Co. of America ("Rothwell"),[39] the court raised a concern about crediting interest retroactively by analyzing the annuity contracts at issue in VALIC and United Benefit. In both VALIC and United Benefit, the insurer held the contract owner's premiums for a period of time before announcing the interest rate at which it would credit interest to the premiums. The court stated that under such retroactive crediting provision, the insurer in each of VALIC and United Benefit was permitted to reflect upon, and essentially pass

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[38] The Company reserves the right to substitute an alternative index if the publication of the index chosen by the Company is discontinued or if its calculation changes substantially.

[39] 191 F.R.D. 25 (D. N.H. 1998).

through, its investment experience and set the rate so that its payment obligations did not exceed it own investment return. Such an arrangement, according to the court, truly shifted the investment risk to contract owners.

The Company's EIA products, however, can be easily distinguished from the features of the contracts of concern to the Associates in Adolescent Psychiatry v. Home Life Insurance Company ("Home Life")[40] and Rothwell courts. In Home Life, the insurer had complete discretion in setting its prospective excess interest rates and excess interest rates were "derived from the rate of return Home Life earned on its general investment portfolio."[41] As the court noted, Home Life did not assume "a great deal of risk by guaranteeing an annual rate of return in advance: the declared rate was based on the performance of Home Life's portfolio over the past year, and only about 6% of the value of the portfolio was reinvested annually."[42] In other words, the insurer minimized the investment risk of prospectively announced excess interest rates by having complete discretion over the rate of excess interest it would declare for upcoming years.

This is in contrast to the EIA products' index interest crediting mechanism. Under the Company's EIA products, the Company bears the substantial investment risk of being obligated to pay out the index interest credit according to the pre-declared formula an cap even if the Company's related investments do not perform at a rate equal to the index feature. Moreover, each EIA product can be totally surrendered for a value that will never be less than the minimum nonforfeiture amount required by the laws of the state in which the EIA product is issued.

In Malone v. Addison Ins. Mktg., Inc. ("Malone")[43] a district court held that an EIA using a traditional equity index crediting method qualified for the exclusion from registration as a security under Section 3(a)(8), and that the annuity contract fell within the Rule 151 safe harbor. The Court found that by locking in the participation rate in advance so that it did not change more frequently than once per year, the EIA contract satisfied Rule 151.

In sum, the Company assumes extensive investment risk under its EIA contracts that is comparable to the risk inherent in the one-year interest rate requirement of Rule 151. The crediting of indexed excess interest based upon pre-declared formulas, participation rates, and caps in the fashion contemplated by the EIA contracts does not result in owners assuming investment risk sufficient to take the EIA. products outside Rule 151 and Section 3(a)(8).

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[40] 941 F.2d 561 (7th Cir. 1991), cert. denied, 502 U.S. 1099 (1992).

[41] Id.

[42] Id.

[43] 225 F. Supp. 2d. 743 (2002).

4. The EIA Products Provide Substantial Cash Value Guarantees

The Company guarantees under each EIA product that in the event of a surrender or non-standard annuitization,[44] the contract owner will receive the cash value.[45] The cash value at any time is the greater of:

(1) the accumulation value[46] as adjusted for any applicable MVA and surrender charges; and

(2) the GMV, which is equal to state nonforfeiture law requirements.

At a minimum, each EIA product provides a "floor" equal to the standard nonforfeiture values (GMV), guaranteeing that in substantially all states a contract owner will never receive less than the sum of 87.5% of net premiums,[47] accumulated at a specified rate of interest that meets the minimum rate under applicable state nonforfeiture law. By providing this rising cash value "floor," the EIA products guarantee a fixed, stated amount of benefits.

The Company maintains that its assumption of the investment risk under the EIA products, as evidenced by the cash value floor (or GMV), is sufficient and consistent with judicial and Commission precedent so as to qualify the EIA products for the Section 3(a)(8) exemption. As the Supreme Court noted in the VALIC case, "insurance" typically involves the insurance company's guarantee that at least some fraction of the benefits will be payable in fixed amounts. Absent some guarantee of fixed income, an annuity places

[44] Standard annuitization occurs if the contract has been in deferral for at least five years, and the contract owner elects annuity payments either for life, or over at least ten years (if annuity Option D is elected under a single-tier product, payments may be made for only five years). An annuitization that does not meet these conditions is considered to be a non-standard annuitization, under which only the cash value will be applied to annuity payments. Under InCommandDex annuity payments are available immediately and the only available annuity options involve lifetime payouts, therefore, only standard annuitization is available on this product.

[45] Cash value is different for two-tier contracts. For MasterDex 10, 10% Bonus PowerDex Elite, and InCommandDex it is equal to 87.5% of total premiums accumulated at an interest rate that is at least equal to the rate required by state nonforfeiture law, adjusted for gross partial surrenders, loans and systematic withdrawal of credits (if applicable). For BonusDex Elite cash value is slightly different in that the Company applies 90% of premiums received in the first contract year, and 100% of premiums received thereafter. Cash value can never be less than the GMV.

[46] Accumulation value is equal to total premiums, plus premium bonuses (if applicable), plus all excess interest, adjusted for gross partial surrenders, loans, and systematic withdrawal of credits (if applicable). For two-tier contracts, the accumulation value is only available through standard annuitization, the systematic withdrawal benefit, or if the death benefit is paid out as annuity payments over at least five years.

[47] Net premiums means all premiums less any withdrawals of credits, surrenders (including any surrender charges and/or partial MVAs), and loans.

all investment risks on the annuitant, thus failing the test of "insurance."[48] Relying on VALIC, the Commission noted in the adopting release for Rule 151 that "absent some element of a fixed return...an annuity contract is outside the scope of Section 3(a)(8)."[49] The Commission has also characterized an insurer's investment risk under an annuity contract that is not a security as including "certain guarantees of principal and interest sufficient for the insurer to be deemed to assume the investment risk."[50]

Providing a guaranteed cash value at least equal to principal (minus an amount equal or equivalent to fees and charges) accumulating at a guaranteed minimum rate also has been viewed as assuming significant investment risk in the U.S. Solicitor General's amicus curiae brief (drafted with significant assistance from the Commission)[51] supporting a grant of certiorari upon VALIC's appeal to the Supreme Court in Otto v. Variable Annuity Life Insurance Co. ("Otto").[52] The Brief argued that, while the owner bore the risk that the excess interest rate under the annuity at issue could be reduced or eliminated at the company's discretion down to the guaranteed minimum rate, the risk of a decline should be balanced against the guaranteed return of premium accumulated at a guaranteed minimum interest rate, and that, as a result, the owner did not bear the investment risk of an erosion in capital contributions. The Brief concluded that with regard to the investment risk criterion of Section 3(a)(8), VALIC, by guaranteeing the return of premium and minimum accrued interest, did assume sufficient investment risk under the contract for it to meet the investment risk criterion of Section 3(a)(8).

The absence of guaranteed minimum nonforfeiture values also has been found to be determinative in United Benefit[53] and Home Life.[54] In United Benefit, the court found that the insurer's investment risk was insufficient to qualify the contract as insurance. In this case, the court noted that the issuer had set the guaranteed cash value at such a low level that the guarantee would never have been operable in the prior fifty years.[55]

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48 VALIC, 359 U.S. 65.

49 Release 6645 at 88,133.

50 Id. at 88,128.

51 Brief for the United States as Amicus Curiae at 6, Variable Annuity Life Insurance Co. v. Otto, 486 U.S. 1026 (May 23, 1988)(No. 87-600) (denying certiorari) (`Brief').

52 814 F.2d 1127 (7th Cir. 1986), rev'd on rehearing, 814 F.2d 1140 (1987), modified, (1987), cert. denied, 486 U.S. 1026 (1988).

53 United Benefit, 387 U.S. 202.

54 Home Life, 941 F.2d 561.

55 United Benefit, 387 U.S. 202.

The EIA products issued by the Company stand in stark contrast to the annuity contracts at issue in United Benefit. State law requires that EIA products must provide minimum guarantees that are at least equal to the state's applicable standard minimum nonforfeiture law requirements for individual annuity contracts. The substantial nonforfeiture guarantees required for EIAs are part of the same statutory framework as the nonforfeiture guarantees for all other traditional deferred fixed annuities.

Thus, through the purchase of either an EIA contract or a traditional fixed annuity, a contract owner will receive a guaranteed minimum surrender value (the GMV) that meets state nonforfeiture requirements. Moreover, while state nonforfeiture guarantees in and of themselves are significant, the Company goes beyond these state nonforfeiture guarantees to provide the cash value, which may be higher than state nonforfeiture requirements.

The guaranteed floor provided by the GMV under the Company's EIA products permits contract owners to accumulate of savings at some level of interest, unlike the United Benefit contract. The United Benefit court contrasted the absence of any promise of "an accumulation of savings at interest" to a promise to "serve as an investment agency and allow the contractholder to share in its investment experience."[56] Similarly, the Seventh Circuit in Home Life distinguished VALIC and other cases[57] because in those cases the excess interest crediting provisions "made the `annuity' look like a mutual fund, with the seller supplying only investment advice."[58] In contrast, the floor provided by the GMV on the EIA products issued by the Company guarantees the sort of meaningful accumulation of savings that is lacking in United Benefit. It is the Company, which is obligated to pay significant guaranteed values, that incurs the investment risk that it may not have sufficient funds to pay the guarantees if the changes in value of its own investment portfolio are not sufficient to meet the guarantee. The Company uses an external index in accordance with a predetermined fixed formula and cap to calculate index interest credits, and the Company in no way serves as an investment agency or allows owners to share in the investment experience of the Company's assets. ***There is no pass-through whatsoever of investment performance.***

In conclusion, it is the Company's position that the EIA contracts substantially comply with Rule 15l's investment risk conditions and qualify for the Section 3(a)(8) exclusion.

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[56] United Benefit, 387 U.S. at 208.

[57] See Otto, 814 F.2d 1127; and Peoria Union, 698 F.2d 320.

[58] Home Life, 941 F.2d at 567 (emphasis added).

B. The Company Assumes Sufficient Mortality Risk Under the Contracts to Qualify the Contracts for the Section 3(a)(8) Exclusion

It is the Company's view that it assumes a meaningful mortality risk of the type that should be considered in determining the availability of the Section 3(a)(8) exclusion.

Like other fixed annuities, EIA products are designed so that while the contracts are in force and before the annuity date, they provide for the payment of a death benefit. If the contract owner dies before the annuity date, the death benefit payable:

- if paid in a lump sum is equal to the greater of: (a) premiums received, less gross partial surrenders, loans, and systematic withdrawal of credits, or (b) the cash value.

- if paid under an annuity option over at least five years is equal to the accumulation value.

For single-tier EIA products, when interest credits are insufficient under (a) in the first bullet point, or the accumulation value is used, the Company waives the surrender charges and MVA upon the death of the contract owner. The waiver of these surrender charges and MVA, and the use of the accumulation value for a two-tier product is significant because the Company is at risk of not having sufficient time to recover its acquisition costs.

In addition, the Company is contractually bound to make a formulaic payment on death even if its investment experience is unfavorable. As a result, the Company is exposed to the mortality risk that the contract owner will die at a time when, due to market conditions, the insurer's investments supporting the EIA contracts' death benefit will be insufficient to cover that benefit. Thus, the Company bears a substantial mortality risk equivalent to that assumed by other insurers under any traditional fixed annuity contract.

In addition to the assumption of mortality risk associated with the payment of the death benefit under the EIA contracts, the Company also assumes mortality risk in connection with the annuity options offered under the EIA contracts. The contract owner has the right to select one of seven annuity options[59] under which the Company will pay out the accumulation value[60] of the EIA product on the annuity date.

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[59] The InCommandDex contract only offers four lifetime annuitization options.

[60] The accumulation value is available for standard annuitization. Standard annuitization occurs if the contract has been in deferral for at least five years, and the contract owner elects annuity payments either for life, or over at least ten years (if annuity Option D is elected under a single-tier product, payments may be made for only five years). An annuitization that does not meet these conditions is considered to be a non-standard annuitization, under which only the cash value will be applied to annuity payments. Under InCommandDex annuity payments are available immediately and the only available annuity options involve lifetime payouts, therefore, only standard annuitization is available on this product.

Four of the seven standard annuity options provide for life income contingencies with annuity payments guaranteed for life.[61] The guaranteed payments are based on the Annuity 2000 Mortality Table at 1% interest, compounded annually, although the Company may pay a higher rate of interest at its discretion. Once an EIA contract is issued, the guaranteed rates cannot be reduced no matter how significantly actuarial estimates of longevity may increase in subsequent years.

By providing guaranteed lifetime annuity options under EIA products that can be selected at some distant future time, the Company assumes a mortality risk that the longevity of the annuitants may be greater than that assumed in setting the guaranteed annuity rates. The Company notes that each life contingent annuity option is based upon rates derived from a table that is commonly used in the industry for annuity contracts. Thus, the Company assumes a meaningful mortality risk through the offer of the life contingent annuity options.

Pursuant to judicial and Commission interpretations, assumption of mortality risk is relevant in determining whether an annuity contract falls within Section 3(a)(8). In VALIC, the Supreme Court stated that the insurer's assumption of mortality risk under an annuity contract "gives [the annuity] an aspect of insurance."[62] The Commission also is of the view that mortality risk may be an appropriate factor to consider in determining the availability of an exemption from Section 3(a)(8).[63] In fact, the United States' amicus curiae brief in Otto stated the Commission's view that:

> Another factor in a Section 3(a)(8) analysis is whether the insurance company assumes a meaningful mortality or longevity risk.... If [an insurance company's] marketing tactics place the status of its fixed-annuity contract in doubt, [the company'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).[64]

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[61] Annuity options offered under the EIA Contracts are set forth in Appendix B.

[62] VALIC, 359 U.S. at 71. See also id. at 81 n.19 (Justice Brennan, concurring) (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, 305, reh'g denied, 563 F.2d 215 (5th Cir. 1977), cert. denied sub nom. Nimmo v. Grainger, 436 U.S. 932 (1978) (it is proper to consider under a Section 3(a)(8) analysis that a life insurance contract provides a significant fixed death benefit); Dryden v. Sun Life Assurance Company of Canada, 737 F. Supp. 1058 (S.D. Ind. 1989), aff'd without opinion, 909 F. 2d 1486 (7th Cir. 1990) (there is a true underwriting of risks by an insurer when the insurer's obligation to pay a death benefit causes it to bear the risk of poor performance of its investments).

[63] See Release 6645 at 88,130 ("[T]he Commission has determined not to include a mortality risk assumption requirement as a separate element of [R]ule 151 . . . However, the Commission is not concluding by this action that consideration of mortality risk assumption has no place in a section 3(a)(8) analysis of annuity contracts outside the "safe harbor." The 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).").

[64] Brief at 9-10.

In view of the risks associated with the death benefit and annuity options under the EIA products, and with the waiver of the surrender charges and MVA, or the use of accumulation value in the calculation of the death benefit, the Company assumes a meaningful mortality risk under the EIA products. This mortality risk is an additional factor supporting the EIA contracts' qualification for the Section 3(a)(8) exemption.

C. The Company Does Not Market the Contracts Primarily as Investments

The Company's EIA products are not marketed primarily as investments. As noted above, the Company has developed two principal disclosure documents for each EIA product: the SOU and the product brochure. All purchasers receive an SOU, and most persons also receive the product brochure, along with other sales materials. The disclosure documents and sales materials together provide a balanced presentation of the EIA product's insurance and financial attributes.

The SOU provides detailed explanations of the insurance features of the applicable EIA product. The intent of the SOU is to provide customers with a comprehensive understanding of how the EIA product works. Thus, a bold-type note appears at the top of the first page, urging prospective purchasers to refer to their contract regarding important terms such as "accumulation value," "cash value" and "surrenders and withdrawals", as they are essential to understanding the EIA product. The SOU describes the EIA product's values, including accumulation value, and cash value, surrender and partial withdrawal features and corresponding charges, death benefit, and tax aspects. The SOU also illustrates the mechanics of the index-linked feature. For example, the SOU sets forth hypothetical examples of the impact index adjustments and caps have on accumulation value, cash value, and GMV. The SOU also provides examples illustrating the effect of partial surrenders and additional premium payments on contract values. The SOU is signed by the selling agent and the customer, and the agent represents on the SOU that he or she has not made statements that differ from the disclosure form.

Similarly, the product brochure for each EIA discusses numerous insurance features provided under the EIA product, including premium bonuses, safety of principal, free withdrawals, and annuitization. The product brochure indicates that the EIA product is an annuity issued by an insurance company backing the contract guarantees, and clearly states that the EIA product is not an S&P 500 and/or Nasdaq-100 indexed mutual fund or other equity investment. The product brochure distinguishes the EIA from investment products by emphasizing the safety of the EIA. product, noting that premiums and interest, once locked in, can never be lost due to market volatility.

Each EIA contract itself, on its cover and back pages, provides in bold face a statement to the effect that contract values may be affected by an external index, but that the EIA product does not directly participate in any stock or equity investments.

Many of the sales materials used in marketing the EIA products also refer to the EIA products' insurance features, including their safety of principal, bonus features (if applicable), withdrawal features, surrender charges, payout options, and provisions for death benefits and nursing home confinement. The materials also describe the EIA products' index-linked excess interest feature, but within the context of describing a retirement savings vehicle that guarantees safety of principal and "locked-in" protection for previously credited interest. The sales materials explain the index interest feature as a feature for those who cannot tolerate risk of loss and who want the potential to benefit from a portion of stock market index gains, up to a maximum. These materials indicate that principal is protected from market index losses.

The Company's marketing is consistent with judicial findings as to the manner in which a contract should be marketed consistent with Section 3(a)(8). In United Benefit, the Supreme Court first articulated the "marketing test" for purposes of Section 3(a)(8), in determining that the annuity in that case did not qualify for the Section 3(a)(8) exclusion under the Federal securities laws. The Supreme Court based its conclusion in part on the manner in which the policies were advertised. The Court noted that the annuity, and contracts like it, were not promoted "on the usual insurance basis of stability and security but on the prospect of `growth' through sound investment management."[65] Such contracts, the court found, were marketed to compete with mutual funds and were pitched to the same consumer interest in growth through professionally managed investment."[66]

The obligation not to market a contract primarily as an investment, however, does not preclude the Company from discussing what may be considered to be the investment aspects of the EIA products. The Federal district court in Home Life determined that the annuity contract was not marketed primarily as an investment just because isolated statements in the company's sales literature referred to the investment aspects of the annuity contract.[67] The court noted that certain statements in marketing materials mentioned the desirability of excess interest as a way of taking advantage of fluctuating interest rates, and that the "sales pitch" for the contract emphasized the insurer's abilities in the management and investment of money. In its opinion, the court stated that the sales literature "does not, when read as a whole, promote the [annuity] primarily as an investment ... Undoubtedly the document refers to the investment aspects and tax-favored features of the plan, and the Court does not question that Home Life and its representatives promoted the [C]ompany's investment abilities in hawking the [annuity]. But that is simply a consequence of the [annuity's] nature as a retirement funding vehicle; shrewd investment is necessary in order to save enough for comfortable retirement."[68]

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[65] United Benefit, 387 U.S. 202.

[66] Id.

[67] Home Life, 941 F.2d 56

[68] Id. (emphasis added).

This finding of the Home Life court was reiterated in the decision of the Federal district court in Berent v. Kemper Corp.[69] In finding that the life insurance policies in question were marketed primarily as insurance, the court determined that "the fact that the sales brochures also discuss the investment features of the policies and that Plaintiffs. . . perceived the policies as investment vehicles does not change . . . the conclusion that the . . . policies were not marketed primarily as investments."[70]

More recently, the court in Malone analyzed a marketing brochure (that promised "stability and flexibility"), the contract form, and a disclosure form for an equity indexed annuity, and found that the materials did not demonstrate the contract was marketed as an investment. Specifically, the Malone court said:

> [M]asking reference to investments in the context of assuring the security of an annuitant's premium, and an aggressive marketing strategy related to the potential for growing that premium have distinct legal significance ... . [The] Court must determine . . . if it appears the marketing emphasis was clearly more correlated to the prospect [of] growth in lieu of stability. [The] brochure, though it mentions the company's `sound financial management,' does so in the context of explaining that the company promises `stability and flexibility.’ ... In addition, the contract itself states plainly . . . that past S&P 500 Index activity is not intended to predict future activity and that the S&P 500 Index does not include dividends... . Moreover, the one-page summary Plaintiff signed, which focused on how her EIA product Value was calculated at any one point to assure her the initial principal plus interest, did not emphasize the potential increase in her assets, but focused on explaining to her that she was guaranteed her principal plus three percent interest.[71]

The court concluded that the equity indexed annuity was "protected by" the Rule 151 safe harbor and was exempt from the Federal securities laws under Section 3(a)(8).

The Commission has not promulgated rules prescribing acceptable or unacceptable marketing techniques for purposes of determining a product's status under Section 3(a)(8). However, it has agreed with judicial determinations that references to investment features of a contract do not preclude a court from finding that the contract was not marketed primarily as an investment. When adopting the standard under Rule 151 that a contract not be marketed primarily as an investment, the Commission explained that "[b]y adopting this standard ... the SEC is not saying, nor has it ever said, that an insurer in marketing its product cannot describe the investment nature of the contract, including its interest rate sensitivity and tax-favored status ... [A] marketing approach that fairly and

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[69] 780 F. Supp. 431 (ED. Mich. 1991); aff'd, 973 F. 2d 1291 (6th Cir. 1992).

[70] Id. at 443.

[71] Malone, 225 F. Supp. 2d. at 753-754.

accurately describes both the insurance and investment features of a particular contract, and that emphasizes the product's usefulness as a long-term insurance device for retirement or income security purposes, would undoubtedly 'pass' the rule's marketing test."[72]

For the reasons discussed above, the Company believes that it does not market the EIA products primarily as investments, and believes that it is marketing the EIA products in a manner consistent with judicial and Commission interpretations of marketing activities that are in accordance with Section 3(a)(8).

XL. CONCLUSION

Because the Company assumes significant investment risks and meaningful mortality risks under the EIA products and because the EIA products are marketed primarily as "insurance," it is the Company's position that its EIA products qualify as annuity contracts pursuant to Securities Act Section 3(a)(8). The EIA products are innovative fixed annuity contracts that provide significant guarantees of principal and credited interest, while providing the potential for annual excess interest to be credited based on formulaic changes in an external index.

The Company hopes you will find this statement responsive to your inquiry. Please feel free to contact me if you would like any further information at 763-765-2913.

Sincerely yours,

Stewart Gregg

Chief Counsel, US Allianz

[72] Release 6645 at 88,137.

ATTACHMENT 2

Brian M. Rom and Kathleen W. Ferguson, *Post-Modern Portfolio Theory Comes of Age*, 4th AFIR International Colloquium 349:364.

Please note that page 350 of Attachment 2 is the French translation of page 349.

POST-MODERN PORTFOLIO THEORY COMES OF AGE

Brian M. Rom
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It has been a generation since Harry Markowitz laid the foundations and built much of the structure of what we now know as Modern Portfolio Theory ("MPT"). The greatest contribution of MPT is the establishment of a formal risk/return framework for investment decision-making. By defining investment risk in quantitative terms, Markowitz gave investors a mathematical approach to asset selection and portfolio management.

But as Markowitz himself and William Sharpe, the other giant of MPT, acknowledge, there are important limitations to the original MPT formulation.

> *Under certain conditions, the mean-variance approach can be shown to lead to unsatisfactory predictions of behavior. Markowitz suggests that a model based on the semi-variance would be preferable; in light of the formidable computational problems, however, he bases his analysis on the variance and standard deviation.*[1]

The causes of these "unsatisfactory" aspects of MPT are the assumptions that 1) variance of portfolio returns is the correct measure of investment risk, and 2) that the investment returns of all securities and assets can be adequately represented by the normal distribution. Stated another way, MPT is limited by measures of risk and return that do not always represent the realities of the investment markets.

Fortunately, recent advances in portfolio and financial theory, coupled with today's increased computing power, have overcome these limitations. The resulting expanded risk/return paradigm is known as Post-Modern Portfolio Theory ("PMPT"). MPT thus becomes nothing more than a special (symmetrical) case of the PMPT formulation.

This article discusses return and risk under MPT and PMPT and demonstrates an approach to asset allocation based on the more general rules permitted by PMPT.

La theorie du portefeuille post-moderne
atteint l'âge de raison

Brian M. Rom
Kathleen W. Ferguson
Sponsor-Software Systems, Inc.

Une génération s'est écoulée depuis que Harry Markowitz a établi les fondations et construit une grande partie de la structure de ce que nous appelons à l'heure actuelle « MPT » (Théorie du portefeuille moderne). La plus grande contribution faite par la MPT est l'établissement d'un cadre officiel de risque/rendement pour la prise de décisions d'investissement. En définissant le risque de l'investissement en termes quantitatifs, Markowitz a mis à la disposition des investisseurs une méthode mathématique pour la sélection des avoirs et pour la gestion du portefeuille.

Mais, comme le reconnaissent Markowitz lui-même ainsi que William Sharpe, l'autre « grand » de la MPT, il existe d'importantes limitations à la formulation originale de la MPT.

> *Dans certaines conditions, l'analyse fondée sur la moyenne et la variance peut s'avérer mener à des prédictions de comportement insatisfaisantes. Markowitz suggère qu'un modèle fondé sur une semi-variance serait préférable ; à la lumière des énormes problèmes de calcul, il fonde cependant son analyse sur la variance et l'écart standard.*[1]

La raison de ces aspects « insatisfaisants » de la MPT est l'assomption que 1) la variance des rendements du portefeuille est la bonne mesure du risque de l'investissement et que 2) les rendements de l'investissement de toutes valeurs et avoirs peuvent être représentés de façon adéquate par la distribution normale. Autrement dit, la MPT est limitée par des mesures du risque et du rendement qui ne représentent pas toujours la réalité des marchés d'investissement.

Heureusement, de récents progrès effectués dans la théorie de la finance et du portefeuille, alliés à des capacités informatiques accrues, ont permis de surmonter ces limitations. Le paradigme du risque/rendement en résultant est connu sous le nom de PMPT (Théorie du portefeuille post-moderne). La MPT devient donc ainsi simplement un cas spécial (symétrique) de la formulation de la PMPT.

Cet article traite du rendement et du risque aux termes de la MPT et de la PMPT et démontre une méthode de répartition des avoirs fondée sur les règles plus générales permises par la PMPT.

MESURES DU RISQUE : DISTINCTION ENTRE BONNE ET MAUVAISE VARIABILITE

Dans la MPT, le risque est défini comme la variabilité totale des rendements autour du rendement moyen et est mesuré par la variance, ou alternativement, l'écart standard.[2] La MPT traite toutes les incertitudes de la même façon - les surprises (c'est-à-dire la variabilité) positives sont pénalisées de façon identique aux surprises négatives. En ce sens, la variance est une mesure *symétrique* du risque et va donc à l'encontre de l'intuition.

Attachment 2-3

RISK MEASURES: DISTINGUISHING BETWEEN BAD AND GOOD VARIAIBLITY

In MPT, risk is defined as the total variability of returns around the mean return and is measured by the variance, or equivalently, standard deviation.[2] MPT treats all uncertainty the same--surprises (i.e., variability) on the upside are penalized identically to surprises on the downside. In this sense, variance is a *symmetric* risk measure, which is counter-intuitive for real-world investors. In fact, intuition argues just the *opposite*--in a bull market we should seek as much volatility as possible; only in a bear market should volatility be avoided! Furthermore, it is well known that individuals are more concerned with avoiding loss than with seeking gain.[3] In other words, from a practical standpoint, risk is not symmetrical--it is severely skewed, with the greatest concern going to the downside.

While variance captures only the risks associated with achieving the *average* return, PMPT recognizes that investment risk should be tied to each investor's specific goals and that any outcomes above this goal do not represent economic or financial risk. PMPT's downside risk[4] measure makes a clear distinction between downside and upside volatility. In PMPT only volatility below the investor's target return incurs risk; all returns above this target cause "uncertainty", which is nothing more than *riskless* opportunity for unexpectedly high returns (Figure 1).

In PMPT this target rate of return is referred to as the minimum acceptable return (MAR). It represents the rate of return that *must* be earned to avoid failing to achieve some important financial objective. Examples of MAR's for pension funds include the actuarial interest rate, the return required to eliminate an underfunded position, and the return required to reduce contributions to a specified level. For individuals, a typical MAR could be the return required to purchase a retirement annuity sufficient to replace a specified proportion of pre-retirement income. As this last example illustrates, the MAR can act as an explicit link between investors' financial requirements and their assets.

Because the MAR is explicitly included in the calculation of PMPT efficient frontiers, there is a unique efficient frontier for each MAR. In other words, for any given set of risk, return and covariance assumptions, there is an infinite number of efficient frontiers, each corresponding to a particular MAR.[5] This stands in contrast to MPT efficient frontiers, in which the investor's goals are never explicitly considered.

Another appealing attribute of PMPT is that the downside risk statistic[6] can be split into two independent components that can then be separately analyzed. In PMPT these two component statistics are known as downside probability[7] and average downside magnitude. Downside probability measures the likelihood of failure to meet the MAR. The average downside magnitude measures the average shortfall below the MAR, for only those instances when the MAR is not achieved. It is thus a measure of the *consequences* of failure. These two statistics provide useful additional perspectives on the nature of the investment risk for a portfolio or asset.

Attachment 2-4

SYMMETRICAL vs. ASYMMETRICAL RETURN DISTRIBUTIONS: NOT ALL DISTRIBUTIONS ARE NORMAL

To represent the underlying uncertainty of asset forecasts, optimization procedures in both MPT and PMPT require a statistical return distribution to be specified for each asset. While MPT permits only the two-parameter normal or lognormal distributions, PMPT utilizes a broader class of asymmetrical distributions. For the analysis presented here, we use the four-parameter lognormal distribution.[8]

The question then arises as to how much asymmetry, or skewness, is observed in the real world. Table 1 shows skewness ratios for several major asset classes over different time periods. Ratios greater than 1.0 indicate distributions with more returns occurring above the median return (positive skewness); the converse is true for ratios less than 1.0 (negative skewness).

All the major asset classes in Table 1 have skewness ratios significantly different from 1.0 for all time periods analyzed. This is compelling evidence that the MPT requirement that all assets have symmetrical return distributions is inappropriate and likely to lead to incorrect results.

The PMPT formulation significantly reduces this problem. Because PMPT provides a more accurate representation of an asset's true shape, PMPT optimization studies will generally provide more accurate results. In addition, PMPT can accommodate severely skewed investment strategies such as portfolio insurance, option-writing, nuclear decommissioning trusts and other derivative-based programs.[9]

POST-MODERN PORTFOLIO THEORY AND PORTFOLIO OPTIMIZATION

Harlow succinctly states the appeal and benefits of using the downside risk framework for portfolio optimization:[10]

> *(The downside risk framework) ... view accords with most investment managers' perception of risk. Downside risk offers an attractive approach to asset allocation decisions. Theoretically more general than the traditional mean-variance technique, it also promises significant improvement in the risk-reward trade-offs to the investor.... That is, a downside risk approach can lower risk while maintaining or improving upon the expected return offered by mean-variance approaches.*

To illustrate the differences between the downside risk and mean-variance approaches, we compare the results using the most general assumptions permitted by each method.[11] The analysis is performed using historical data as proxies for expectations of future asset behavior. Although the results vary according to changes in the ex ante assumptions, the process of using historical data to assist in the formulation of future expectations is common. In any case, our focus is on exploring the usefulness of an alternative portfolio construction technique rather than on producing return forecasts.

Our example is fairly typical for a U.S.-based investor. There are five asset choices: large-capitalization stocks, small-capitalization stocks, non-U.S. stocks, bonds, and cash. The returns used in this example cover the 15-year period from January, 1978 to December, 1992 and are presented in Table 2.[12] Efficient portfolios of these assets are constructed using the PMPT and MPT techniques described below, a 10% MAR, and a five-year holding period.

The PMPT efficient frontier is calculated using an algorithm for downside risk developed by The Pension Research Institute[13] applied to the expected return, standard deviation and skewness values shown in Table 2. Figure 2 shows the downside risk efficient frontier and identifies the reference portfolios described below.

The MPT efficient frontier is calculated using standard Markowitz optimization techniques applied to the expected returns and standard deviations shown in Table 2. Figure 3 shows the MPT mean-variance efficient frontier and identifies the reference portfolios.

To assist in comparisons of portfolios generated from optimizations under the techniques, the following benchmark portfolios are used: (1) the minimum-risk efficient portfolio to represent the most risk-averse investor; (2) the maximum-efficiency portfolio to represent the purely rational investor; and (3) the Brinson Partners Global Securities Normal Portfolio[14] to represent the typical global investor.

DOWNSIDE RISK vs. MEAN-VARIANCE OPTIMIZATION

The Minimum-Risk Portfolios

Minimum-risk portfolios are shown in Table 3. Under mean-variance, the minimum-risk portfolio is practically an all-cash portfolio. As an indication of the limitations of mean-variance optimization, this portfolio is identified as the least risky; yet with certainty it will fail to deliver the 10% required return! This illustrates how mean-variance analysis can recommend illogical investment strategies and is a direct result of using standard deviation as the investment risk measure. The inefficiency of the mean-variance minimum risk portfolio is obvious in that it is located substantially below the downside risk efficient frontier in Figure 2.

Contrast this with the downside risk minimum-risk portfolio which has a substantial non-cash component. This diversification into higher-return, higher-volatility assets reflects the 10% MAR requirement which cannot be achieved by the low-return, low-volatility cash component on its own.

Table 4 shows the two components of downside risk--downside probability and average downside magnitude. These provide additional insights into how the riskiness of cash is viewed by the two optimization methods. For example, the low downside risk of cash is primarily a consequence of this asset's low average downside magnitude, despite the relatively high downside probability. Nonetheless, the downside risk minimum-risk portfolio holds substantially less cash than its mean-variance counterpart because the risk-reduction properties are significantly less under downside risk than under mean-variance. This is shown in Table 5, which displays the risk of each asset relative to cash. Notice, for example, that the mean-variance risk of large-cap stocks is 19 times greater than that of cash, but only 1.3 times greater using downside risk at a 10% MAR. This explains the disparity between the two optimization methods in the allocation to large-cap stocks.

A comparison of columns 2 and 3 in Table 5 shows how in the downside risk framework the MAR can change an asset's risk relative to cash. Notice the rapid climb in riskiness of the assets relative to cash when the MAR falls to 8% from 10%. This is a direct reflection of the sharp decline in the downside risk of cash as the lower MAR moves into its range of possible outcomes.

The Maximum-Efficiency Portfolios
Table 6 shows the downside risk and mean-variance maximum-efficiency[15] portfolios. The differences between these portfolios are explained by the efficiencies of the respective assets shown in Table 7.[16] Under mean-variance, cash is so much more efficient than the other assets that it dominates the maximum-efficiency portfolio with a 97% allocation. On the other hand, under downside risk, large-cap stocks are most efficient, which explains the 81% allocation to this asset. As noted previously, an asset's efficiency relative to other assets would be expected to change as the MAR changes.

The inefficiency of the mean-variance maximum-efficiency portfolio is obvious in that it is located substantially below the downside risk efficient frontier in Figure 2.

The Equivalent-Risk Portfolios
We define an equivalent-risk portfolio as an efficient portfolio with the same risk as a specified reference portfolio, for which we use the Brinson Partners Global Securities Normal Portfolio. Table 8 shows the mean-variance and downside risk equivalent-risk portfolios.

Notice that the downside risk portfolio has a higher allocation to large-cap stocks and lower weightings to foreign stocks and bonds than the mean-variance portfolio. These differences are attributable primarily to the assets' skewness. For example, the positive skewness of large-cap stocks makes this asset more appealing in the downside risk optimization (where the skewness is recognized) than in the mean-variance case (where the skewness is ignored). Similarly, the negative skewness of foreign stocks and bonds explains the relative underweighting in these assets under downside risk.

Importantly, this example illustrates the impact of ignoring asset skewness when performing mean-variance optimization: for large-cap stocks, mean-variance ignores some of the "good" returns on the upside, resulting in an *overestimation* of the actual risks inherent in this asset; for foreign stocks and bonds, mean-variance ignores some of the "bad" returns on the downside, resulting in an *underestimation* of the actual risks of these assets. This means that the mean-variance equivalent-risk portfolio is neither efficient nor optimal.

CONCLUSIONS

Recent advances in portfolio theory and computer technology today provide investors with capabilities unheard of even a few years ago. Among these is Post-Modern Portfolio Theory ("PMPT"), which uses downside risk and asymmetrical return distributions, providing analysts with flexibility and accuracy in constructing efficient portfolios unavailable under traditional Markowitz mean-variance methodology.

Examples of policy decisions using these two optimization techniques show how mean--variance analysis can produce illogical and counter-intuitive results and how PMPT can rectify these problems.

By providing a more accurate and robust framework for constructing optimal portfolio mixes, Post-Modern Portfolio Theory has made much needed improvements to the fundamental work done by Markowitz and Sharpe on portfolio theory.

ENDNOTES:

[1]Sharpe, W.F., (1964) *Capital Asset Prices: A Theory of Market Equilibrium under Considerations of Risk*, The Journal of Finance, XIX, 425. Markowitz recognized these limitations and proposed downside risk (which he called "semi-variance") as the preferred measure of investment risk. However, due to the complex calculations and the limited computational resources at his disposal, practical implementation of downside risk was impossible. He therefore compromised and stayed with variance.

[2]In Modern Portfolio Theory, the terms variance, variability, volatility, and standard deviation are often used interchangeably to represent investment risk.

[3]*Why Investors Make the Wrong Choices*, Fortune Magazine, January, 1987.

[4]There are many references to downside risk in the literature. The following is a partial list of those we feel are most relevant to our article. (See Bawa, V.S., *Stochastic Dominance: A Research Bibliography,* Management Science, June, 1982, for a complete bibliography.) Fishburn, P.C., *Mean-Risk Analysis with Risk Associated with Below-Target Variance,* The American Economic Review, March, 1977; Sortino, Frank and v.d. Meer, Robert, *Downside Risk: Capturing What's at Stake,* The Journal of Portfolio Management, Summer, 1991; Clarkson, R.S., *A Presentation to The Faculty of Actuaries (British)*, February 20, 1989.

[5]See Table 5 for an illustration. For example, notice in the downside risk framework the rapid climb in relative risk of each asset when the MAR falls to 8% from 10%. This is explained by the sharp decline in the downside risk of cash as the MAR moves into the cash range of possible outcomes.

[6]Downside risk is measured by target semi-deviation, the square root of target semi-variance. Downside risk is an asymmetric risk measure that calculates the probability-weighted squared deviations of those returns falling below a specified target rate of return (the MAR).

[7]Downside probability is also known as shortfall risk. See Leibowitz, M.L. and Langetieg, T.C., *Shortfall Risks and the Asset Allocation Decision,* Salomon Brothers, January, 1989.

[8]The additional parameters permit independent shifting of the left and right tails of the lognormal distribution. For many years financial theorists and practitioners have recognized that, for many common asset classes, traditional methods of representing return distributions do not adequately capture empirically observed results. The lognormal distribution used for the analysis here overcomes many of these objections.

[9]Lewis, A.L., *Semivariance and the Performance of Portfolios with Options,* Financial Analysts Journal, July-August, 1990; Study on CTA Managers, Sponsor-Software Systems, Inc., February, 1993; *Post-Modern Portfolio Theory Spawns Post-Modern Optimizer,* Money Management Letter, February 15, 1993.

[10]Harlow, W.V., *Asset Allocation in a Downside Risk Framework,* Financial Analysts Journal, September-October, 1991.

[11]Although our examples utilize PMPT's most general capabilities--asymmetric return distributions and downside risk--we emphasize that the benefits of downside risk described still apply if symmetrical return distributions are used. Space limitations preclude us from including further examples to illustrate this point. These are available from the authors on request.

[12]Throughout this article, the following market indexes are used as proxies for major asset classes: Standard & Poor's 500 Stock Index for large-cap stocks; Russell 2000 Stock Index for small-cap stocks; MSCI Europe, Australia, Far East Stock Index for foreign stocks; Lehman Brothers Aggregate Bond Index for bonds; 90-Day Treasury Bills for cash.

[13]The not-for-profit Pension Research Institute at San Francisco State University wrote the first commercial downside risk optimizer. This algorithm is used by *The Asset Allocation Expert*, a PC-based optimization software system developed and distributed by Sponsor--Software Systems, Inc. This system is used to generate the results described in this article.

[14]We use a summarized form of this portfolio: 39% large-cap stocks, 17% small-cap stocks, 19% foreign stocks, 20% bonds, and 5% cash. See *Investment Review*, Brinson Partners, Inc., 1992; page 7.

[15]In downside risk, the maximum-efficiency portfolio is the efficient portfolio with the highest Sortino ratio: (rate of return-MAR)/(downside risk). In mean-variance, the maximum-efficiency portfolio is the efficient portfolio with the highest modified Sharpe ratio: (rate of return)/(standard deviation).

[16]Covariances between assets also will affect the results. This information is available from the authors on request.

AUTHORS:

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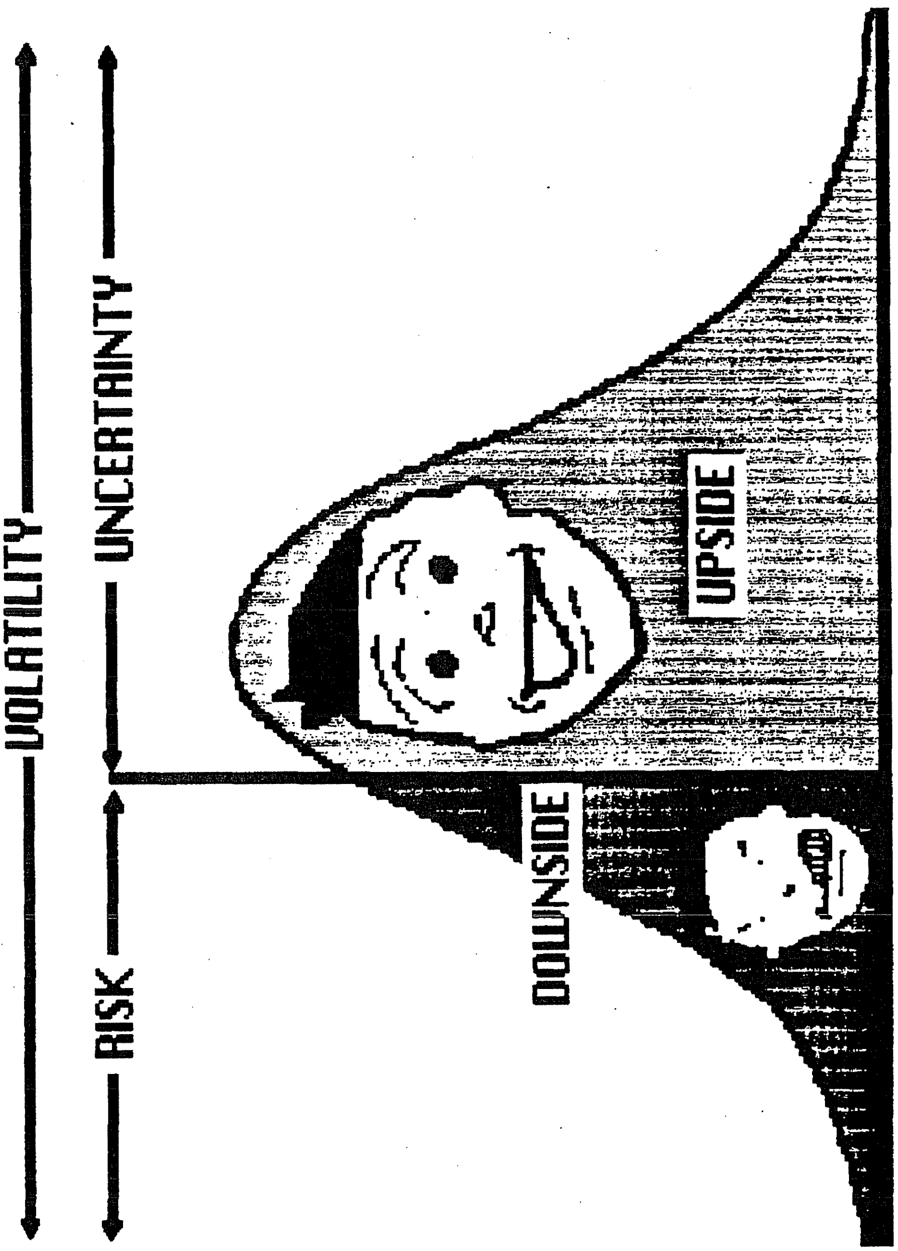
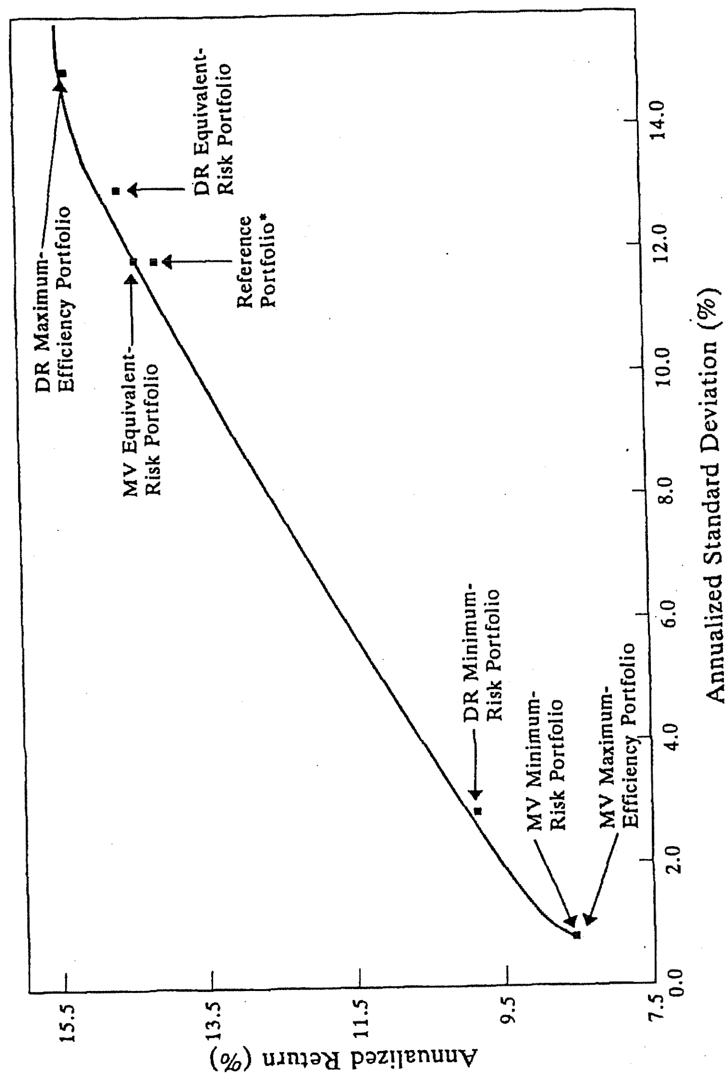

VOLATILITY
RISK
UNCERTAINTY
UPSIDE
DOWNSIDE

MPT EFFICIENT FRONTIER
5-Year Holding Period



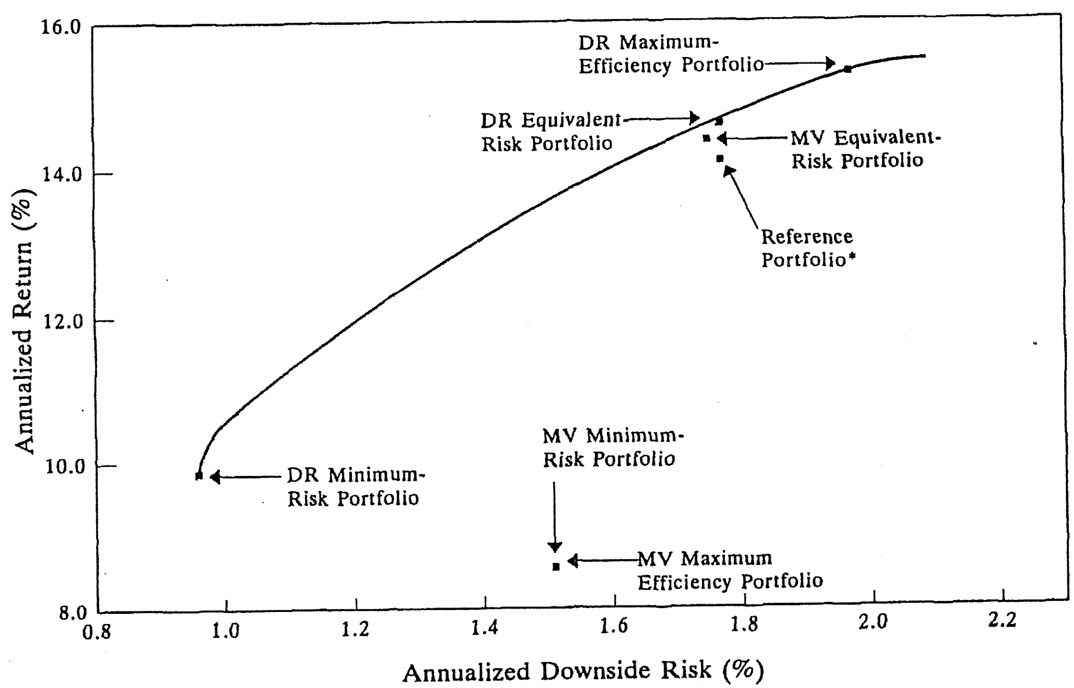
DR=Downside Risk; MV=Mean-Variance
*Brinson Partners Global Securities Normal Portfolio.

Attachment 2-12

PMPT EFFICIENT FRONTIER

5-Year Holding Period

10.0% Minimum Acceptable Return



DR=Downside Risk; MV=Mean-Variance

*Brinson Partners Global Securities Normal Portfolio.

Table 1
Skewness of Major Asset Classes and Inflation*

	Periods Ending 12/31/92		
Asset	10 Yrs	20 Yrs	30 Yrs
Large-Cap Stocks	1.80	1.23	0.89
Small-Cap Stocks	1.07	1.22	1.14
Foreign Stocks	0.92	1.10	NA
Bonds	0.83	0.94	0.97
Cash	0.64	1.25	1.11
Inflation	0.82	1.35	3.03

*Skewness equals (High 10th Percentile Return - Median Return)/(Median Return - Low 10th Percentile Return)

Table 2
Return and Risk Assumptions for Optimizations*

Asset	Expected Return	Standard Deviation	Skewness**
Large-Cap Stocks	15.45%	15.80%	1.22
Small-Cap Stocks	15.44	20.50	1.20
Foreign Stocks	15.30	18.26	0.85
Bonds	10.59	7.49	0.92
Cash	8.45	0.83	1.19

*Actual data from 1978 to 1992.
**Skewness equals (High 10th Percentile Return - Median Return)/(Median Return - Low 10th Percentile Return)

Table 3
Comparison of Minimum-Risk Portfolios
Five-Year Holding Period, 10.0% MAR

Portfolio Mix	Mean-Variance	Downside Risk	Difference
Large-Cap Stocks	0%	11%	+11%
Small-Cap Stocks	0	0	0
Foreign Stocks	1	4	+3
Bonds	2	18	+16
Cash	97	67	-30
Portfolio Characteristics			
Expected Return	8.55%	9.86%	+1.31%
Risk:			
Downside Risk	1.51%	0.96%	-0.55%
Standard Deviation	0.80%	2.84%	+2.04%
Downside Prob	100.0%	55.4%	-44.6%
Avg Downside Mag	1.51%	1.29%	-0.22%

Table 4
Components of Downside Risk
for Individual Assets
Five-Year Holding Period, 10.0% MAR

Asset	Downside Risk	Downside Probability	Average Downside Magnitude
Large-Cap Stocks	2.09%	23.2%	4.35%
Small-Cap Stocks	3.36	29.2	6.22
Foreign Stocks	4.49	27.1	8.64
Bonds	1.85	40.8	2.90
Cash	1.62	100.0	1.62

Attachment 2-15

Table 5
Risk for Individual Assets
Relative to Cash
Five-Year Holding Period

Asset	Mean-Variance*	Downside Risk 10% MAR	Downside Risk 8% MAR
Large-Cap Stocks	19.0	1.3	14.2
Small-Cap Stocks	24.7	2.1	25.7
Foreign Stocks	22.0	2.8	37.6
Bonds	9.0	1.1	10.3
Cash	1.0	1.0	1.0

*Standard deviation

Table 6
Comparison of
Maximum-Efficiency Portfolios
Five-Year Holding Period, 10.0% MAR

Portfolio Mix	Mean-Variance	Downside Risk	Diff-erence
Large-Cap Stocks	0%	81%	+81%
Small-Cap Stocks	0	0	0
Foreign Stocks	1	17	+16
Bonds	2	1	-1
Cash	97	1	-96
Portfolio Characteristics			
Expected Return	8.55%	15.30%	+6.75%
Risk:			
Downside Risk	1.51%	1.97%	+0.46%
Standard Deviation	0.80%	14.93%	+14.13%
Efficiency Ratio:			
Downside Risk*	-0.96	2.70	+3.66
Mean-Variance**	10.71	2.48	-8.23

*The Sortino ratio = (Expected Return - MAR)/Downside Risk
**The Sharpe ratio = Expected Return/Standard Deviation

Table 7
Efficiency Measures and Rankings for Individual Assets

Asset	Mean-Variance Efficiency Ratio*	Mean-Variance Rank	Downside Risk at 10% MAR Efficiency Ratio**	Downside Risk at 10% MAR Rank
Large-Cap Stocks	1.0	3	2.6	1
Small-Cap Stocks	0.8	5	1.6	2
Foreign Stocks	0.8	4	1.2	3
Bonds	1.4	2	0.3	4
Cash	10.0	1	-0.9	5

*The Sharpe ratio = Expected Return/Standard Deviation
**The Sortino ratio = (Expected Return - MAR)/Downside Risk

Table 8
Comparison of Equivalent-Risk Portfolios
5-Year Holding Period, 10.0% MAR

Portfolio Mix	Mean-Variance	Downside Risk	Reference Portfolio*
Large-Cap Stocks	50%	65%	39%
Small-Cap Stocks	0	0	17
Foreign Stocks	29	18	19
Bonds	21	17	20
Cash	0	0	5
Portfolio Characteristics			
Expected Return	14.38%	14.60%	14.10%
Risk:			
Downside Risk	1.75%	1.77%	1.77%
Standard Deviation	11.86%	13.00%	12.23%
Efficiency Ratio:			
Downside Risk**	2.50	2.61	2.32
Mean-Variance***	1.21	1.12	1.15

*Brinson Partners Global Securities Normal Portfolio
**The Sortino ratio = (Expected Return - MAR)/Downside Risk
***The Sharpe ratio = Expected Return/Standard Deviation

ATTACHMENT 3

A comparison of the relative range of risk between securities and FIAs.

The following table compares historical returns of different types of investments for the period 1926 to 2007, to the hypothetical returns of three types of Allianz FIAs based on historical data for the same period. The annual point-to-point and monthly sum FIAs represent the largest number of historically issued contracts, and the monthly average FIA is our current fastest growing crediting method. We based this data on a contract owner placing all money in the S&P 500 Index allocation option.

The table below examines both standard risk measures and downside risk measures. Standard risk measures, such as average return and standard deviation, focus on the volatility of returns and do not differentiate between gains and losses. We note that based on these traditional measures FIAs appear to have a somewhat higher return than bonds with more volatility and perceived risk exposure.

Alternatively, downside risk measures focus on the risk of actual loss to the consumer. There are numerous downside risk measures which are consistent with the current theories of investment risk. The table below examines a few of these measures and demonstrates how FIAs protect against downside risk compared to the exposure of securities which have a risk of loss.

These risk measures are described in a required textbook for acquiring the Certified Financial Analyst ("CFA") designation: CFA Program Curriculum - Volume 4 - Asset Valuation and Equity - Level II 2008.copyright 2008 by CFA Institute. Pages 626-628.

	Data[1] From 1926 to 2007									
	Risk Measures	Large Stocks	Small Stocks	Long-Term Corporate Bonds	Long-Term Government Bonds	Inermediate-Term Government Bonds	U.S. Treasury-Bills[2]	An Annual Point-to-Point FIA With an 8% Cap[3]	A Monthly Sum FIA With a 3% Cap[4]	A Monthly Average FIA With a 2% Spread[5]
Standard Risk Measures	Average Return[6]	12.7%	17.8%	6.2%	5.8%	5.4%	3.8%	5.5%	6.7%	7.5%
	Standard Deviation[7]	21.6%	36.5%	8.6%	8.9%	5.6%	3.1%	3.5%	7.4%	9.0%
Downside Risk Measures	VaR 95%[8]	-22.8%	-33.2%	-5.9%	-5.9%	-0.8%	0.1%	0	0	0
	VaR 99%[9]	-43.5%	-58.8%	-10.5%	-9.8%	-3.9%	0	0	0	0
	Minimum Return[10]	-67.6%	-75.9%	-18.2%	-17.1%	-5.5%	-0.1%	0	0	0
	Number of Negative Returns[11]	248	264	183	216	83	27	0	0	0
	Average Loss[12]	-13.7%	-18.5%	-4.2%	-3.8%	-1.7%	0	0	0	0
	Standard Deviation of Loss[13]	12.4%	16.8%	3.2%	3.1%	1.5%	0	0	0	0
	Sortino Ratio[14]	0.72	0.84	0.74	0.63	1.08	0	Infinite (no downside risk)	Infinite (no downside risk)	Infinite (no downside risk)

(1) From Ibbotson SBBI 2008 Valuation Yearbook.

(2) U.S. Treasury Bill figures are based on the Merrill Lynch 3-Month Treasury Bill Index. The Merrill Lynch 3-Month Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. Each month the index is rebalanced and the issue selected is the outstanding Treasury Bill that matures closest to, but not beyond three months from the rebalancing date. Due to the short term horizon of these instruments and our use of one year returns, at a very simplified level, these yields somewhat approximate an annualized risk free return.

(3) An annual point-to-point FIA takes the annual return of the S&P 500 Index based on the index values at the beginning and end of the year and credits any positive interest subject to a cap of 8% and a floor of 0%.

(4) A monthly sum FIA adds together each monthly return of the S&P 500 Index based on the index values at the beginning and end of each month. Positive monthly returns are subject to a cap of 3%, but there is no limit on negative monthly returns. At the end of the year all the monthly returns are added together, and if the result is positive we then credit that interest to the contract, with a floor of 0%.

(5) A monthly average FIA first records the initial S&P 500 Index value on the last day of the previous year. Next we record the index values on the same day each month for 12 months and then average these results. At the end of the year we take this average, subtract the initial index value, and divide the result by the initial index value to determine the average change. Finally, we subtract the 2% annual spread from the average change, and if the result is positive we then credit that interest to the contract, with a floor of 0%.

(6) The “Average Return” is the average return for the entire 82-year period.

(7) “Standard Deviation” measures the uncertainty in the return: the higher the standard deviation, the more uncertain the return. For example, a standard deviation of zero would indicate the return is certain. A higher standard deviation represents both higher upside and also lower downside potential, in comparison with a different investment type with a lower standard deviation.

(8) “VaR” stands for “value at risk.” It measures the return which can be exceeded with a given likelihood. “VaR 95%” indicates a 95% chance that your return will be higher than the number shown below, or in the alternative, a 5% chance your return will be lower than the number shown below.

(9) “VaR” stands for “value at risk.” It measures the return which can be exceeded with a given likelihood. “VaR 99%” indicates a 99% chance that your return will be higher than the number shown below, or alternatively, a 1% chance your return will be lower than the number shown below.

(10) The “Minimum Return” represents the worst single year return for the entire period.

(11) The “Number of Negative Returns” is a count of the number of 12 month periods from 1926 through 2007 for which the investment type experienced a negative return.

(12) The “Average Loss” shows the average loss for all years that had a negative return.

(13) The “Standard Deviation of Loss” is a measure of the variation in expected loss for all years that had a negative return, or the variation you could expect the average loss to have.

(14) The final statistic is the “Sortino Ratio,” which is the risk-adjusted reward: it is the ratio of reward divided by risk. A higher ratio is desired, as the higher the ratio means there is a greater return provided for the amount of risk of loss taken.

ATTACHMENT 4

This material is taken from a presentation to Commissioners and staff of the United States Securities and Exchange Commission regarding Regulation of Equity Index Annuity Products, dated September 20, 2006. Statistical information in this attachment has not been updated since the date of the original document.

2. IS AN EIA INSURANCE OR A SECURITY?

EIAs are not well understood by many people in the securities industry and the financial press. Because EIAs credit interest by reference to market indices, some assume that the owner of an EIA is exposed to that "investment" and that the product simply "passes through" performance like a variable annuity contract or a share of a mutual fund. This assumption is not correct. Rather, EIAs are virtually indistinguishable from traditional fixed annuities, as follows:

- Like any other fixed annuity contract, an EIA is backed by all of the assets in an insurer's general account, and not just the assets of an insurer's separate account.

- Like any other fixed annuity contract, the issuer of an EIA must invest the assets in its general account in accordance with state "permitted investment" laws. These "safety and soundness" laws restrict or prohibit investment in junk bonds, equity securities, and other types of risky investments.

- Insurers issuing EIAs must meet the same substantial capital requirements as issuers of traditional fixed annuities. As of December 31, 2005, Allianz maintained capital against EIA liabilities of approximately $1.6 billion.

- Like all other fixed annuity contacts, substantially all premium dollars received from EIA contract owners are invested by the insurance company in bonds. Currently, Allianz invests over 95% of the premiums received from the owners of EIAs in bonds, with the rest invested in options to hedge index performance.

- Like any other fixed annuity contract, insurers establish credited rates (or "caps") for EIAs primarily by reference to current bond rates (rather than by reference to equity index performance) and these "caps" will move up or down based upon bond market returns. For example, on September 7, 2005, in information provided to the staff of the Commission, Allianz indicated that the "cap" on its MasterDex 5 product was 2.4% monthly as of June 2005. As of May 2006, following an increase in bond interest rates, the MasterDex 5 has a monthly cap for current sales of 2.8%.

- Like all other fixed annuity contracts, EIAs do not have a mortality and expense risk (M&E) charge or a contract maintenance charge. Like other fixed annuity contracts, there are no Rule 12b-1 Plan or other asset-based fees.

- Like all other fixed annuity contracts, EIAs do not have an advisory fee or management fee.

- Like all other fixed annuity contracts, EIAs are protected by state guaranty funds, which function in a manner similar to FDIC insurance for bank demand and time deposits. Currently, all states provide at least $100,000 of coverage for a fixed annuity.[1]

- Like all other fixed annuity contracts, EIAs must meet minimum state nonforfeiture requirements. These nonforfeiture requirements provide a minimum value or "floor" that must be paid out on a full surrender, compounded at a minimum non-indexed interest rate. In addition to the minimum values provided for by state nonforfeiture laws, EIAs issued by Allianz also provide a second floor by contract that provides that annual index credits can never be negative. (This is insurance against market risk.)

- Like all other fixed annuity contracts, the issuer, not the owner of an EIA, bears the investment risk on the contract.

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[1] In some states, this coverage functions differently from FDIC insurance, and may not cover 100% of an annuity contract's value. However, as discussed infra in Section 3, it appears that owners of fixed annuity contracts are at least as well protected as holders of demand and time deposits whose bank is insured by the FDIC.

ATTACHMENT 5

This material is taken from a Presentation to Commissioners and staff of the United States Securities and Exchange Commission regarding Regulation of Equity Index Annuity Products, dated September 20, 2006. Statistical information in this attachment has not been updated since the date of the original document.

3. INSURANCE REGULATION

A. HOW ARE CONSUMERS PROTECTED BY STATE INSURANCE LAWS?

State insurance laws provide extensive and comprehensive protection to owners of EIAs (and other fixed annuities). These protections are provided primarily by "safety and soundness" laws, but they are also provided by a variety of other types of laws and regulations, e.g., disclosure and suitability regulation. State-law protections include the following:

- Issuers of EIAs are required to be licensed in each jurisdiction in which their contracts are offered. In addition, annuity contracts and applications are required to be filed with and reviewed by each such state.

- Issuers of EIAs must file extensive annual financial information with state regulatory authorities.

- Insurers are subject to "financial examinations" and "market conduct examinations" in each state in which they do business.[2] **In 2005 alone, Allianz was the subject of seven examinations by seven different state insurance departments. (These examinations resulted in only minor issues.)**

- Because EIAs and all other fixed annuity contracts are supported by an insurer's general account, they are subject to state "permitted investment" laws. These laws substantially reduce the systemic risk in the insurer's investment portfolio.[3]

- Insurers are subject to substantial capital requirements under state law and through rating agency requirements with respect to EIAs. **Allianz maintained excess capital of $1.6 billion against EIA liabilities as of December 31, 2005.**

- Owners of EIAs and all other fixed annuity contracts have a priority over general creditors of the insurer in the event of its insolvency. A copy of M.S.A. Section 60B.44 is attached as Exhibit 2.

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[2] State examinations may be substantially more extensive than typical securities examinations. One state examination of Allianz conducted in 2005, by the State of Minnesota, involved 5 examiners and lasted eleven months. As is typical with state examinations, Allianz paid the cost of this examination, which totaled $682,000 in external costs (internal costs would be approximately equal to external costs). In state examinations, it is not uncommon for the state to hire external experts to assist in the exam, e.g., independent auditors or actuaries.

[3] As a Minnesota-domiciled company, Allianz is subject to the following investment restrictions on its general account:

- investment in common and preferred stocks in the aggregate cannot exceed 25% of admitted assets (M.S.A. Section 61A.28 subd. 6(b));
- investment in non-investment grade bonds must be limited to 15% of admitted assets (M.S.A. Section 61A.28 subd. 6(f)(3));
- mortgage loan investments must meet principal coverage tests (M.S.A. Section 61A.28 subd. 3); and
- hedging cannot be "for speculative ... purposes" (M.S.A. Section 61A.28 subd. 9(a)).

In addition, each insurer is required to have a written investment policy, and compliance with this policy must be reviewed annually by the insurer's board of directors. M.S.A. Section 60A.112.

- Owners of EIAs and all other fixed annuity contracts are protected by state "guaranty funds" in all 50 states in a minimum amount of $100,000. **In 2005, Allianz paid** assessments **of $2.3 million to state guaranty funds.** A copy of M.S.A. Section 61B.19 and a 50-state survey of state guaranty fund laws are attached as Exhibit 3. Recent research indicates that state guaranty funds may protect purchasers of fixed annuity contracts as well as, and perhaps better than, FDIC insurance protects the owners of bank demand and time deposits. See Exhibit 4.

- EIAs and all other fixed annuity contracts are required to provide minimum nonforfeiture "floors" on contract surrender values. As such, a contract owner can surrender a contract in the early years of a contract and still be assured of receiving at least 87.5% of her premiums plus 1.5% interest annually. The exact amount received may vary by state.

- Owners of all fixed annuity contracts receive a written contract with protections that generally cannot be changed without the consent of the contract owner.

- Advertisements for fixed annuity contracts are subject to comprehensive sales disclosure regulation. A copy of the NAIC model regulation on advertising is attached as Exhibit 5.

- Owners of EIAs, like owners of all other fixed annuity contracts, receive the benefit of a consumer protection "cooling off period" in the form of a right to a 10-day "free look." A copy of M.S.A. Section 72A.51 is attached as Exhibit 6.

- EIAs, like all other fixed annuity contracts, are subject to specialized consumer disclosure laws, including contract "readability" requirements and specialized disclosures on exchanges. A copy of M.S.A. Sections 72C.09 and 61A.60 and the Allianz replacement form for Minnesota are attached as Exhibit 7.

- EIAs, like all other fixed annuity contracts, are subject to state suitability requirements. Allianz goes beyond applicable state requirements, and obtains suitability information in all annuity transactions, in all states, and from purchasers of all ages.

Recent suggestions in the public press that there are "gaps" in the regulation of fixed annuity contracts and that fixed annuity contracts are "thinly regulated" are without any foundation in fact.

ATTACHMENT 6

This material is taken from a Presentation to Commissioners and staff of the United States Securities and Exchange Commission regarding Regulation of Equity Index Annuity Products, dated September 20, 2006. Statistical information in this attachment has not been updated since the date of the original document.

B. DO STATE INSURANCE LAWS ACTUALLY PROVIDE BETTER PROTECTIONS FOR CONSUMERS THAN FEDERAL SECURITIES LAWS? WOULD PURCHASERS OF SECURITIES PRODUCTS BENEFIT FROM THE APPLICATION OF CONSUMER PROTECTIONS PROVIDED BY INSURANCE LAWS?

In many respects, state insurance regulation provides substantially better consumer protection than Federal securities regulation. As such, it is highly debatable whether insurers issuing EIAs should be subjected to an additional, expensive, arguably anticompetitive regulatory overlay in the form of securities-style regulation.

Moreover, in any discussion of a true "level playing field" for financial services companies, it would be appropriate to consider whether certain insurance-type protections should be extended to purchasers of securities. The following is a list of insurance-law protections and corresponding securities-law "deficiencies."

- Purchasers of annuity contracts are given the benefit of a "cooling off period" in the form of a "free look" right, whereas purchasers of securities are not.

  Should purchasers of securities be given the right to a ten- to thirty-day "free look" similar to that provided in state insurance laws?

- Owners of EIAs and other fixed annuity contracts receive very substantial protection in the form of state minimum nonforfeiture laws. These laws are both beneficial to consumers and expensive for insurance companies to implement. Moreover, the protections are very meaningful. **Allianz has back tested its top single-tier[4] EIA, the MasterDex 5, from 1960 through 2004, and has found that state minimum nonforfeiture values would have been higher** than **S&P 500 Index values in fully 18% of one-year periods, 28% of three-year periods, 30% of five-year periods, and 36% of ten-year periods. See page 13.**

  Should an investment adviser to a mutual fund be required to provide consumer protections in the form of a "floor" on invested value of 87.5% of investment plus minimum guaranteed interest? In the alternative, should a broker-dealer be deemed to have recommended unsuitable investments if more than a certain percent of her customer's assets are invested in products without floors?

[4] Under a single tier EIA, contract owners can take a lump sum withdrawal of the contract value after expiration of the surrender charge period. Two tier EIAs are specifically designed to encourage contract owners to take guaranteed income payments, either through annuitization or a series of systematic withdrawals, and so have a higher annuitization value than surrender value.

- Allianz delivers a simple, plain-English disclosure document to each purchaser of an EIA at or before the sale of the annuity contract. In contrast, Section 5 of the 1933 Act permits direct or telephone sales of mutual fund shares so long as the mutual fund's prospectus is delivered with the confirmation of the transaction. Since a telephone transaction is effective when the telephone order is received and entered, the customer does not receive a prospectus containing important disclosure until approximately a week after the transaction is completed. And these types of transactions are common.

  Should Section 5 be amended to require the delivery of a prospectus prior to the completion of all securities transactions? Or, as noted above, should customers be given the benefit of a "free look" after the prospectus is delivered?

- Owners of fixed annuity contracts receive the benefit of a written contract with numerous protections that generally cannot be changed by the issuer. In contrast, without the consent of all of a mutual fund's shareholders:

  - Management and other fees can be increased;
  - A Rule 12b-1 Plan, which authorizes payments for distribution to be made out of the mutual fund's assets, can be implemented;
  - The investment strategy and even "fundamental policies" of a fund can be changed;
  - The investment objective can be changed (e.g., a large cap growth fund can be changed to a mid cap fund, or the definition of "small cap" for a small cap fund can be changed).

  Should a mutual fund purchaser be permitted to redeem his or her shares without any contingent surrender charge, and receive a rebate of any front-end sales charge, if the terms governing her investment in the mutual fund are significantly changed?

- Insurers issuing EIAs are subject to requirements in state insurance laws and independent rating agency requirements to maintain minimum capitalization. **For example, in 2005, Allianz maintained capital against EIA liabilities of $1.6 billion. The cost of this capital to Allianz in 2005 was approximately $130 million.** In contrast, broker-dealers selling shares of mutual funds are subject to minimal capital requirements. Mutual fund complexes structured as "series funds" can set up dozens of funds with only $100,000 of initial "seed" capital. Investment advisers to mutual funds are not subject to any minimum capital requirements whatsoever. Similarly, broker-dealers only selling shares of mutual funds may operate with minimal net capital.

  Should investment advisers to mutual funds and broker-dealers selling shares of mutual funds be required to have meaningful capital?

- Owners of EIAs receive substantial protections from state guaranty funds. **In 2005, Allianz paid a total of $2.3 million in assessments to state guaranty funds for protection of customers of other insurers.** Purchasers of securities such as mutual fund shares do not receive the benefit of any comprehensive insurance protection on shares that they own. Mutual funds are not required to maintain any insurance coverage other than relatively minimal fidelity bonding coverage. While certain broker-dealers are required to pay into the SIPC fund, broker-dealers selling only shares of mutual funds are exempt from SIPC coverage. Broker-dealers are required to maintain relatively small fidelity bonds.

Should mutual funds, investment advisers to mutual funds, and broker-dealers selling only shares of mutual funds be required to establish and maintain guaranty funds?

- While not required to do so by state insurance law, most fixed annuity contracts permit the owner to effect charge-free withdrawals. This reflects the fact that annuities are "insurance," and provide access to contract value for various contract owner emergencies and insurance needs. For example, many of the Allianz EIA products provide a 10% free withdrawal privilege each year without imposition of any contingent surrender charge. **In 2005, Allianz paid out $150 million in free withdrawals, at an estimated cost of approximately $20 million in foregone contingent surrender charges.**

  Should mutual funds be required to address customer emergencies by providing a free withdrawal right or, where the sales commission was paid at purchase, permitting a limited withdrawal each year, which includes a rebate of the applicable front-end sales load?

- Insurers issuing EIAs are subject to permitted investment laws.

  Should there be suitability restrictions on a broker-dealer selling shares of mutual funds to senior citizens where the mutual fund's fundamental investment objective is to invest in junk bonds, emerging market stocks, or other speculative securities?

- Questions have been raised whether EIAs with significant contingent surrender charges should be sold to persons over a specified age. If such restrictions are per se good public policy, should not similar restrictions be imposed on sales to seniors of mutual funds with front-end sales loads or contingent deferred sales charges?

ATTACHMENT 7

This material is a current version of the Allianz FIA Suitability Form as of August 12, 2008.

Allianz Life Insurance Company
of North America
PO Box 59060
Minneapolis, MN 55459-0060

Allianz

Product Suitability Form

Thank you for your interest in an Allianz annuity. Before we can process your application and issue your policy, we need to confirm that the annuity purchase suits your current financial situation and long-term goals. **Please complete this form in its entirety and submit with your application.**

Owner's name[1]	Age	Product name
Joint owner's name	Age	Premium amount

Annuity type ☐ Qualified ☐ Nonqualified

Your privacy is a high priority to us. The information you provide will be treated with the highest degree of confidentiality.

Financial status

1. **Approximate** current monthly **household[2] income** $________________
   - Including, but not limited to, salary, Social Security payments, pension/retirement benefits, investment and rental income
   - Do not include income currently earned on the money that will be used to purchase this annuity
2. **Approximate** current monthly **household living expenses** $________________
   - Including, but not limited to, housing, transportation, insurance, food, healthcare and taxes (include property, income, and FICA taxes)
3. **Disposable income** (current monthly household income minus current monthly household living expenses) $________________

   a. After the purchase of this annuity, will your monthly income meet or exceed your monthly expenses? ☐ Yes ☐ No

   b. The surrender period or deferral-plus-annuitization period (whichever is longer) of the annuity applied for is ________________.

   c. Do you anticipate any significant **increase in living expenses or decrease in your household's monthly income** during the surrender period or deferral-plus-annuitization period (whichever is longer)? ☐ Yes ☐ No
   - Examples of a reduction in household income might be retirement or a lower pension payment
   - Examples of increases in living expenses might be housing, medical, nursing home, assisted living, or travel expenses
   - If "yes" to 3.c, please explain (if possible, approximate when you anticipate changes in income, living expenses, and the amount)

____

____

____

4. What is your **marginal federal tax rate?** ☐ 0% ☐ 10% ☐ 15% ☐ 25% ☐ 28% ☐ 33% ☐ 35%
5. **Approximate household net worth** $________________
   - Total household assets (including premium for the annuity to be purchased but excluding primary residence and any personal belongings or personal property such as jewelry, furnishings, and vehicles)
   - Minus total debt (not including mortgage or debt owed on the primary residence)
6. **Approximate household liquid assets** $________________
   - Do not include any assets that will be used for the purchase of this annuity or any withdrawals that may be taken from this annuity
   - Include assets such as checking, savings, money market accounts, and securities that can be sold without fees or penalty
   - Do not include any personal belongings or personal property such as jewelry, furnishings, and vehicles
7. In purchasing this annuity, **what percentage of your liquid assets** will be used? ________________%
8. Do you anticipate any **significant reduction in your liquid assets** during the surrender period or the deferral-plus-annuitization period (whichever is longer)? ☐ Yes ☐ No
9. **Total value** of all annuities (include the purchase of this annuity) $________________
   - What is the total accumulation/annuitization value of all annuities you own with Allianz and other companies?
10. **Nursing home** or **assisted living facility**
    - Does the owner reside in a nursing home or assisted living facility? ☐ Yes ☐ No

[1] For trust and corporate owned contracts, see agent guide for instructions on completion of form
[2] Household means the owner and spouse/partner, if a member of the owner's household

Allianz Life Insurance Company
of North America
PO Box 59060
Minneapolis, MN 55459-0060

Product Suitability Form

Financial objectives

1. What are your **financial objectives** in purchasing this product? **(check all that apply)**
   ☐ Income now ☐ Guarantees provided ☐ Growth potential ☐ Growth followed by income
   ☐ Tax-deferred growth ☐ Pass on to beneficiaries ☐ Other______________________
2. What other **financial products** do you own or have you previously owned? **(check all that apply)**
   ☐ None ☐ Certificates of deposit ☐ Fixed annuities ☐ Variable annuities ☐ Stocks/bonds/mutual funds
3. What is your **source** for this annuity's premium? **(check all that apply)**
   ☐ Annuity ☐ Life insurance ☐ Certificates of deposit ☐ Other investments
   ☐ Reverse mortgage/home equity loan ☐ Savings/checking
4. Is this a **replacement** of an annuity or life contract? ☐ Yes ☐ No
   a. **If yes**, what type(s)? ☐ Fixed ☐ Fixed index ☐ Variable
   b. If yes, is there a surrender charge? ☐ Yes ☐ No
   c. **If there is a surrender charge,** what is it on each contract being replaced? ___% ___% ___% ___%

Accessing your money

1. **How** do you anticipate taking **distributions** from this annuity? **(check all that apply)**
   ☐ Free/systematic withdrawals ☐ Annuitize ☐ Required minimum distribution ☐ Enhanced Withdrawal Benefit
   ☐ Lump sum ☐ Loans ☐ Leave to beneficiary ☐ Immediate income
2. **When** do you anticipate taking your **first distribution** from this annuity? **(choose one)**
   ☐ Less than one year ☐ Between one and five years ☐ Between six and nine years
   ☐ 10 or more years ☐ None anticipated
3. **I understand** how my beneficiaries can receive the **maximum contract value?** ☐ Yes ☐ No

NOTE: If this form is not completed, signed, and dated, we cannot consider your application.

I acknowledge that I have read the Statement of Understanding for the product listed and believe it meets my needs at this time. To the best of my knowledge and belief, the information above is true and complete. I understand that I should consult my tax advisor regarding possible tax implications of the purchase of an annuity or the exchange of an existing annuity or life insurance contract.

Owner's signature		Date
Joint owner's signature		Date
Agent signature	Agent number	Date

ATTACHMENT 8

This material is a current version of the Allianz MasterDex 5 Plus^{SM} Annuity Statement of Understanding as of January 2008.

Allianz Life Insurance Company
of North America
PO Box 59060
Minneapolis, MN 55459-0060
800.950.7372

Allianz

Allianz MasterDex 5 Plus℠ Annuity
Statement of Understanding

Thank you for considering the Allianz MasterDex 5 Plus Annuity. We want to be sure that you are aware of the features, benefits, costs, and risks associated with the purchase of your contract.

Please read the following summary, and fully discuss each of the aspects of the contract described below with your agent. If you need additional clarification of any of the items listed below, please refer to the annuity contract.

Once you have read this summary, and discussed it completely with your agent, please sign the last page to confirm you understand the contract you are considering.

How does the Allianz MasterDex 5 Plus Annuity work?
The Allianz MasterDex 5 Plus Annuity is a fixed index insurance product. This means interest may be credited to your annuity's value based on the performance of one or more nationally recognized market indexes.

You can choose to earn interest credits based on the S&P 500, the Nasdaq-100®, the FTSE 100, or a blended index option that contains a predefined mix of domestic and international equity indexes along with a bond index.

Does the Allianz MasterDex 5 Plus Annuity have a bonus?
Yes, the Allianz MasterDex 5 Plus Annuity offers a premium bonus. This means that each time you make a premium payment during the first five contract years, we will add a bonus to your accumulation value. This bonus will equal 5% of each premium payment. Keep in mind that bonus annuities may have a higher surrender charge and a longer surrender charge schedule than you would get from similar annuities without the bonus feature.

How do I choose – and change – the way my annuity's value is allocated?
You can allocate all of your money to any of the index options mentioned above. If you prefer you can designate all of your premium to earn fixed interest. In addition, when you purchase your annuity you can also divide its value and allocate it (in 1% increments) to any 10 of these 12 options.

Shortly after each contract anniversary you will receive an annual report. It will include a form that allows you to change your current allocations. If that is your intention, you must complete the allocation change form and return it to the Home Office within 21 days after your contract anniversary. This will lock in your request and determine how your contract values are allocated over that contract year. If the form is not received within 21 days after your contract anniversary, your changes will not take effect until the next contract anniversary.

Assuming I choose the fixed interest option, how is fixed interest calculated and credited to my contract?
If you don't want your potential interest credits to be based solely on index changes, the Allianz MasterDex 5 Plus Annuity allows you to allocate, or designate, some or all of your annuity's value to a fixed interest option. This fixed interest option credits your contract with predictable interest based on rates we establish that are not based on a market index. Your initial interest rate is guaranteed for the first contract year. We can change the interest rate each contract year thereafter, but we guarantee it will be no less than 1.5% in all contract years. Your fixed interest is calculated and credited daily.

Assuming I allocate my money to an index option, how is interest calculated and credited to my contract?
If you choose the S&P 500, Nasdaq-100, or FTSE 100 option(s), you can choose either annual point-to-point, monthly sum, or monthly average as your crediting method (or you can allocate some of your money to each crediting method). The blended index option is only available with the annual point-to-point and monthly average crediting methods.

Can you describe how annual point-to-point crediting works?
With annual point-to-point crediting, we capture the value of each index on the last business day before your contract is issued. We then capture it exactly one year later (and then on the last business day before each subsequent contract anniversary). We take the current year's index value and subtract the prior year's index value to determine how much the index has changed over that contract year. We then divide that difference by the prior year's index value, to determine the percentage of change that took place during the contract year.

As long as the percentage of change for an index does not exceed its stated annual cap (which we will define later), the indexed interest rate we will credit to your contract will be equal to the year's full percentage of change. If the percentage of change is greater than the annual cap, the annual cap percentage will be the indexed interest rate we will credit to your contract. If the percentage of change for an index is negative, the portion of your contract value allocated to that index option will not lose any value, but it will receive no indexed interest for that year.

Now can you describe monthly sum crediting?
We again start by capturing the value of each index on the last business day before your contract is issued. With monthly sum crediting, however, we capture the index value 12 more times each year, on the last business day before each of your contract's "monthiversaries." If your contract is dated the 14th of the month, for example, your monthiversary will be the 14th of every month throughout the life of your contract.

Each month, we take the current month's index value and subtract the previous monthiversary's index value. We then divide the difference (either positive or negative) by the previous month's index value. This determines the monthly return. For any month in which the monthly return exceeds the monthly cap for that index, the monthly cap percentage will be used to calculate the indexed interest rate you will receive. At the end of each contract year, we total these 12 monthly percentages (whether positive or negative) to determine the indexed interest rate we will credit to your contract for the year.

If the 12 monthly percentages for an index add up to a negative percentage, the portion of your contract value allocated to that index option will not lose any value, but it will receive no indexed interest for that year.

Can you describe how monthly average crediting works?
As is the case with monthly sum crediting, we start by capturing the value of each index on the last business day before your contract is issued. We then capture the index value 12 more times each year, on the last business day before each of your contract's monthiversaries. These 12 values are then added together, and divided by 12 to find the average. We take this average and subtract the starting index value, and then divide that difference by the starting index value to determine the percentage of change that took place during the contract year. Finally we subtract a spread (which we'll define later) from the percentage of change. If still positive, this is the indexed interest rate we will credit to your contract value for that contract year. If the result is negative, the portion of your contract value allocated to that index option will not lose any value, but it will receive no indexed interest for that year.

What are caps and spreads, and how do they affect my contract's potential growth?
A cap is a preset limit on the percentage of indexed growth that we use in calculating any indexed interest we credit to your contract each year. With annual point-to-point crediting, we apply an annual cap. If the percentage of change for an index during a contract year exceeds its annual cap, the annual cap percentage is the indexed interest rate you will receive. With monthly sum crediting, we apply a monthly cap. If the monthly return for an index during a contract month exceeds its monthly cap, the monthly cap percentage is used to calculate the indexed interest rate you will receive.

For monthly average crediting, there is no cap, but there is a spread. A spread is a preset deduction from the percentage of indexed growth that we use to calculate the indexed interest rate we credit to your contract each year. We subtract a spread from the percentage of change to determine the indexed interest rate you will receive.

Annual caps, monthly caps, and spreads for the first contract year are established when you purchase your contract. We may change these caps and spreads on each contract anniversary for the coming contract year. Annual caps will never be less than 3%. Monthly caps will never be less than 1.25%. Spreads will never be more than 5%.

Can I see how these three crediting methods could work?

Shown below are historical S&P 500 index values taken from three recent years. Each year was selected because it showcases the difference in hypothetical indexed interest rates calculated using the three crediting methods.

In each year we sample, one of the crediting methods outperforms the other two. So it is apparent that **no single crediting method offers superior performance under all market index conditions.**

For each of the years shown, we illustrate two columns of hypothetical values. The first column illustrates minimum values the annuity would have guaranteed if its caps and spread were at their "worst case" levels.

The column to the right shows values the annuity would have generated at hypothetical (nonguaranteed) caps and spread.

Monthly average crediting would have produced the greatest growth in 1998:

End of month	S&P 500 index value	Monthly return	Capped at 1.25%	Capped at 2.50%
Dec	*970.43*	–	–	–
Jan	980.28	1.02%	1.02%	1.02%
Feb	1049.34	7.04%	1.25%	2.50%
Mar	1101.75	4.99%	1.25%	2.50%
Apr	1111.75	0.91%	0.91%	0.91%
May	1090.82	-1.88%	-1.88%	-1.88%
Jun	1133.84	3.94%	1.25%	2.50%
Jul	1120.67	-1.16%	-1.16%	-1.16%
Aug	957.28	-14.58%	-14.58%	-14.58%
Sep	1017.01	6.24%	1.25%	2.50%
Oct	1098.67	8.03%	1.25%	2.50%
Nov	1163.63	5.91%	1.25%	2.50%
Dec	1229.23	5.64%	1.25%	2.50%
Average	1087.86	**Sum**	-6.95%	1.80%

If you had selected annual point-to-point crediting:	At 3% cap	At 6.5% cap
Beginning year index value:	970.43	970.43
Ending index value:	1229.23	1229.23
Percentage of change:	26.67%	26.67%
Indexed interest rate:	**3.00%**	**6.50%**
If you had selected monthly sum crediting:	At 1.25% cap	At 2.5% cap
Sum of capped monthly returns:	-6.95%	1.80%
Indexed interest rate:	**0.00%**	**1.80%**
If you had selected monthly average crediting:	At 5% spread	At 1.5% spread
Beginning year index value:	970.43	970.43
Average index value:	1087.86	1087.86
Percentage of change:	12.10%	12.10%
Indexed interest rate:	**7.10%**	**10.60%**

Monthly sum crediting would have produced the greatest growth in 2004:

End of month	S&P 500 index value	Monthly return	Capped at 1.25%	Capped at 2.50%
Dec	*1111.92*	–	–	–
Jan	1131.13	1.73%	1.25%	1.73%
Feb	1144.94	1.22%	1.22%	1.22%
Mar	1126.21	-1.64%	-1.64%	-1.64%
Apr	1107.30	-1.68%	-1.68%	-1.68%
May	1120.68	1.21%	1.21%	1.21%
Jun	1140.84	1.80%	1.25%	1.80%
Jul	1101.72	-3.43%	-3.43%	-3.43%
Aug	1104.24	0.23%	0.23%	0.23%
Sep	1114.58	0.94%	0.94%	0.94%
Oct	1130.20	1.40%	1.25%	1.40%
Nov	1173.82	3.86%	1.25%	2.50%
Dec	1211.92	3.25%	1.25%	2.50%
Average	1133.97	**Sum**	3.10%	6.78%

If you had selected annual point-to-point crediting:	At 3% cap	At 6.5% cap
Beginning year index value:	1111.92	1111.92
Ending index value:	1211.92	1211.92
Percentage of change:	8.99%	8.99%
Indexed interest rate:	**3.00%**	**6.50%**
If you had selected monthly sum crediting:	At 1.25% cap	At 2.5% cap
Sum of capped monthly returns:	3.10%	6.78%
Indexed interest rate:	**3.10%**	**6.78%**
If you had selected monthly average crediting:	At 5% spread	At 1.5% spread
Beginning year index value:	1111.92	1111.92
Average index value:	1133.97	1133.97
Percentage of change:	1.98%	1.98%
Indexed interest rate:	**0.00%**	**0.48%**

Annual point-to-point crediting would have produced the greatest growth in 2005:

End of month	S&P 500 index value	Monthly return	Capped at 1.25%	Capped at 2.50%
Dec	*1211.92*	–	–	–
Jan	1181.27	-2.53%	-2.53%	-2.53%
Feb	1203.60	1.89%	1.25%	1.89%
Mar	1180.59	-1.91%	-1.91%	-1.91%
Apr	1156.85	-2.01%	-2.01%	-2.01%
May	1191.50	3.00%	1.25%	2.50%
Jun	1191.33	-0.01%	-0.01%	-0.01%
Jul	1234.18	3.60%	1.25%	2.50%
Aug	1220.33	-1.12%	-1.12%	-1.12%
Sep.	1228.81	0.69%	0.69%	0.69%
Oct	1207.01	-1.77%	-1.77%	-1.77%
Nov	1249.48	3.52%	1.25%	2.50%
Dec	1248.29	-0.09%	-0.09%	-0.09%
Average	1207.77	**Sum**	-3.76%	0.63%

If you had selected annual point-to-point crediting:	At 3% cap	At 6.5% cap
Beginning year index value:	1211.92	1211.92
Ending index value:	1248.29	1248.29
Percentage of change:	3.00%	3.00%
Indexed interest rate:	**3.00%**	**3.00%**
If you had selected monthly sum crediting:	At 1.25% cap	At 2.5% cap
Sum of capped monthly returns:	-3.76%	0.63%
Indexed interest rate:	**0.00%**	**0.63%**
If you had selected monthly average crediting:	At 5% spread	At 1.5% spread
Beginning year index value:	1211.92	1211.92
Average index value:	1207.77	1207.77
Percentage of change:	-0.34%	-0.34%
Indexed interest rate:	**0.00%**	**0.00%**

How is interest calculated for the blended index option?

The blended index option is made up of multiple market indexes in fixed percentages, or weights, that will not change during the life of your contract. The indexes (and their weights) are as follows: Dow Jones Industrial Average (35%), Lehman Brothers U.S. Aggregate Index (35%), FTSE 100 Index (20%), and Russell 2000 (10%). To calculate the indexed interest rate for the blended index, the percentage of change for each index in the blend is calculated using either the annual point-to-point or the monthly average methods we described previously, and then the percentages are combined according to the weight of each index.

The hypothetical example below shows how the indexed interest rate for the blended index option would be calculated.

	Beginning index value	Ending or average index value	Percentage of change	Weight	Weighted percentage of change
Index 1	2422.70	2589.00	6.864%	X35%	= **2.402%**
Index 2	53.65	62.00	15.564%	X35%	= **5.447%**
Index 3	2753.20	2633.66	-4.342%	X20%	= **-0.868%**
Index 4	168.31	189.00	12.293%	X10%	= **1.229%**

In this example, the sum of the four bold weighted percentages of change = 8.21%.

Note that, for the annual point-to-point method, an annual cap is applied to the sum of the weighted percentages of change, not to each individual weighted percentage of change. As long as the sum of the weighted percentages of change for the blended index option does not exceed its stated annual cap, the indexed interest rate we will credit to your contract under the annual point-to-point crediting method will be equal to the year's full weighted percentage of change. If the sum of the weighted percentages of change for the blended index option exceeds the annual cap, the annual cap percentage is the indexed interest rate you will receive under that method. If the sum of the weighted percentages of change is a negative percentage, the portion of your contract value allocated to that index option will not lose any value, but it will receive no indexed interest for that year. For the monthly average crediting method, we will credit the year's full weighted percentage of change minus the spread. If the result after subtracting the spread is negative, the portion of your contract value allocated to that index option will not lose any value, but it will receive no indexed interest for that year.

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

No. If the index(es) suffer a loss in any given year, your principal (the money you put into the annuity) is protected. Any interest – fixed or indexed – that has been previously credited is also safe from index losses. However, your annuity's value will be affected by when – and how – you decide to take money out of the contract.

Although an external index may affect your contract values, the contract does not directly participate in any stock or investments. You are not buying any bonds, shares of stock, or shares of an index. The market index value does not include the dividends paid on the stocks underlying a stock index. These dividends are also not reflected in the interest credited to your contract.

Does this annuity have a participation rate?

Yes. The participation rate determines how much of the percentage of indexed growth for an index option will be used to calculate the interest that is credited to your contract. The participation rate is 100% and is guaranteed for the life of the contract. Keep in mind, the amount of any gains allowed by your participation rate will still be subject to the cap(s) or the spread(s) for your selected index(es) and crediting methods.

How will I know the value of my annuity contract?

The first thing you should know is that, throughout the life of your annuity contract, the Allianz MasterDex 5 Plus℠ Annuity will actually have three separate values. Access to each of these values depends on when – and how – you take money out of the annuity. Those values are the:

- Accumulation value
- Cash surrender value
- Guaranteed minimum value

Accumulation value. The accumulation value equals the premium you pay into the contract, plus a 5% premium bonus and any interest credits earned. Withdrawals and any applicable surrender charges will decrease your contract's accumulation value.

Cash surrender value. The cash surrender value is your accumulation value minus any applicable surrender charge. The surrender charge applies during the first 10 contract years and may result in the loss of some or all of your premium bonus, previously credited interest, and a partial loss of principal. We discuss surrender charges later.

Guaranteed minimum value. In addition to the two values just discussed, we provide a guaranteed minimum value with all fixed annuities. You would receive your contract's guaranteed minimum value only if it were higher than your contract's cash surrender value. The guaranteed minimum value equals 87.5% of your total premium, minus any withdrawals, growing at an annual interest rate no less than 2.0% nor greater than 3%, depending on your selection of indexed and/or fixed interest allocation options.

Can I see an illustration of the various values associated with my annuity?

The following examples show hypothetical values for an Allianz MasterDex 5 Plus Annuity that was purchased with an initial premium of $100,000. Example 1 shows 100% of the premium payment allocated to an index option with annual point-to-point crediting, a guaranteed minimum value interest rate of 2.0%, and no additional premium payments. Table 1 shows an assumed annual cap of 6.5% (nonguaranteed), Table 2 shows the guaranteed minimum annual cap of 3%. You can track the changes in the $100,000 initial premium and 5% bonus as they are impacted by the hypothetical changes in the index.

Notice the relationship between the accumulation value and the cash surrender value. You can see that once the contract has completed its 10-year surrender charge period, its accumulation value and cash surrender value are identical. That means that anytime after your 10th contract anniversary, you would be free to cancel your contract and receive your entire accumulation value. The guaranteed minimum value is also listed for your reference.

Example 1

Table 1 (Assumes 6.5% annual cap)

End of contract year	Percentage of change	Indexed interest rate	Accumulation value	Surrender charge	Cash surrender value	Guaranteed minimum value
Issue			$105,000	15.00%	$ 89,250	$ 87,500
1	31.0%	**6.50%**	$111,825	15.00%	$ 95,051	$ 89,250
2	26.7%	**6.50%**	$119,094	15.00%	$101,230	$ 91,035
3	19.5%	**6.50%**	$126,835	15.00%	$107,810	$ 92,856
4	-10.1%	0.00%	$126,835	12.86%	$110,527	$ 94,713
5	-13.0%	0.00%	$126,835	10.71%	$113,245	$ 96,607
6	-23.4%	0.00%	$126,835	8.57%	$115,963	$ 98,539
7	26.4%	**6.50%**	$135,079	6.43%	$126,395	$100,510
8	9.0%	**6.50%**	$143,859	4.29%	$137,694	$102,520
9	3.0%	3.00%	$148,175	2.14%	$145,000	$104,571
10	13.6%	**6.50%**	$157,806	0.00%	$157,806	$106,662

In years 1, 2, 3, 7, 8, and 10, the percentage of change exceeds the assumed annual cap. Therefore, the indexed interest rate in each of those years is equal to the assumed annual cap of 6.5%.

Table 2 (Assumes guaranteed minimum 3% annual cap)

End of contract year	Percentage of change	Indexed interest rate	Accumulation value	Surrender charge	Cash surrender value	Guaranteed minimum value
Issue			$105,000	15.00%	$ 89,250	$ 87,500
1	31.0%	3.00%	$108,150	15.00%	$ 91,928	$ 89,250
2	26.7%	3.00%	$111,395	15.00%	$ 94,685	$ 91,035
3	19.5%	3.00%	$114,736	15.00%	$ 97,526	$ 92,856
4	-10.1%	0.00%	$114,736	12.86%	$ 99,985	$ 94,713
5	-13.0%	0.00%	$114,736	10.71%	$102,443	$ 96,607
6	-23.4%	0.00%	$114,736	8.57%	$104,902	$ 98,539
7	26.4%	3.00%	$118,178	6.43%	$110,581	$100,510
8	9.0%	3.00%	$121,724	4.29%	$116,507	$102,520
9	3.0%	3.00%	$125,375	2.14%	$122,689	$104,571
10	13.6%	3.00%	$129,137	0.00%	$129,137	$106,662

In years 1, 2, 3, 7, 8, and 10, the percentage of change exceeds the guaranteed minimum annual cap. Therefore, the indexed interest rate in each of those years is equal to the annual cap of 3.0%.

I see there is a surrender charge. What is it?

The surrender charge is the penalty you pay to surrender (cancel) or withdraw all or part of your contract during the first 10 contract years. The surrender charge starts at 15% of the contract's accumulation value and it decreases by 0.1786% on each monthiversary beginning in contract year four. On the first day of contract year 11, it will decrease to zero.

This chart details the surrender charges during the first 10 contract years for any withdrawals that are subject to a penalty. If you take a full or partial withdrawal that is subject to a penalty during this time, we will apply the surrender charge shown to your withdrawal.

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

Note: The above chart shows annual decreases in the surrender charge. Actually, it decreases monthly (at a rate of 0.1786% per month), from year four until day one of contract year 11.

How do I avoid surrender charges?

After 10 contract years you will avoid surrender charges, and you can take your full accumulation value as a lump sum. During the surrender charge period, you can also take penalty-free partial withdrawals (which are described later) from your contract, and no surrender charges or other contract penalties will apply. Regardless of whether a withdrawal is penalty-free or subject to a surrender charge and/or other contract penalty, however, any time you take a withdrawal from your annuity it may be subject to taxes (which are discussed later).

Can I take money out of my annuity without incurring a surrender charge while the contract is in deferral?

Yes. It's quite possible you will want money from your annuity contract somewhere down the road. But you may not need it all. We offer a variety of ways you can get some of your money out of your annuity without incurring surrender charges, including:

- Penalty-free partial withdrawals
- Contract loans
- Required minimum distributions
- Our Nursing Home Benefit

How can I take a penalty-free partial withdrawal from my contract?[1]

A penalty-free partial withdrawal will not be subject to a surrender charge, although taxes and tax penalties may apply. A penalty-free partial withdrawal will reduce each of your guaranteed minimum value and accumulation value by the partial withdrawal amount. If the partial withdrawal is not penalty-free, your guaranteed minimum value will be reduced by the partial withdrawal amount and your accumulation value will be reduced by the partial withdrawal amount and any associated surrender change.

To be penalty-free, a partial withdrawal must meet all of the following conditions:

- The partial withdrawal must be taken after the contract anniversary following your most recent premium; and
- The cumulative partial withdrawal amount within a contract year must not exceed 10% of your total premium paid.

We will recalculate any penalty-free partial withdrawal as if it were not penalty-free under certain conditions. We will make this recalculation if, within a contract year after you take a penalty-free partial withdrawal:

- You request a full surrender; or
- You send us additional premium.

Penalty-free partial withdrawals from index allocations are eligible to receive interest at the end of the contract year the withdrawals were taken. This interest is based on the indexed interest rate and

[1] In certain states we will recalculate any penalty-free partial withdrawal as if it were not penalty-free if you request another partial withdrawal that causes your cumulative partial withdrawal amount within a contract year to exceed 10% of your total premium paid.

the amount of time during that year before each free withdrawal was taken.

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

I understand I may have to take required minimum distributions someday. Does my annuity allow these?
Based on your age (usually 70½ or older) and the tax designation of your contract (IRA, SEP, etc.) you may have to take minimum distribution payments. If they are taken annually in December or monthly throughout the year, required minimum distributions (RMDs) are penalty-free, although they will reduce or eliminate the amount available for other penalty-free partial withdrawals. You may not exceed the annual RMD amount specified by the IRS, which will be based on your age and the value of your contract, without incurring surrender charges. Allianz will only send a required minimum distribution for the contracts you have with us, and only if you request that we do so.

How can your Nursing Home Benefit help me access my money without surrender charges or other contract penalty?
After the first contract anniversary, if you are the contract owner and you become confined to a nursing home for 30 out of 35 consecutive days, your full accumulation value can be paid to you as annuity payments over as little as five years.

How do I avoid surrender charges and get my contract's full accumulation value?
To avoid surrender charges and receive 100% of your annuity's full accumulation value, you must keep the contract in force at least until your 10th contract anniversary – at this point the surrender charge expires. After you have held your contract for at least 10 contract years, then you can take your contract's full accumulation value as a lump-sum payment.

After the fifth contract year you also have the option to take interest-only annuity payments over the next five years, or after the first contract year payments of both principal and interest over a period of at least 10 years. This is what is meant by "annuitization." Once you begin taking your accumulation value as annuity payments, it will no longer receive additional fixed and/or indexed interest.

If you decide not to keep your contract in force for 10 full years, or if you choose an annuity payment option different from those listed below, you will receive your contract's cash surrender value rather than its accumulation value.

Please note: Even when surrender charges are no longer a factor, there may still be tax consequences when you withdraw money from your annuity. See "Are there tax consequences if I withdraw money?" later in this document.

What are my options for receiving annuity payments?
After you keep your contract in deferral for at least five contract years, you can choose to receive annuity payments in any of the following ways.

- Interest only – You have the option to receive interest-only annuity payments for five years. Interest will be paid as earned based on your then-current accumulation value. After five years of taking interest-only payments, you may then take your accumulation value as a lump-sum payment.
- Installments for a guaranteed period – You can choose to receive annuity payments in equal installments for a period from 10 to 30 years. Each installment would consist of part principal and part interest.
- Installments for life – You have the option to receive annuity payments in equal installments for the rest of your life. Payments end upon your death, even if we have paid only one annuity payment at the time you die.
- Installments for life with a guaranteed period – You can choose to receive annuity payments in equal installments for the rest of your life. Upon your death, payments for the balance of the guaranteed period, if any, will be paid to your beneficiary in the same way as they were previously being made.
- Installments for a selected amount – You may select to receive annuity payments in equal installments of an amount that you choose, as long as the payments last for at least 10 years. Payments continue until your accumulation value and interest are gone.
- Joint and survivor – You can select to have equal installments paid until your death with additional payments to your named survivor. In this case, payments to your named survivor would continue until his or her death at 100%, 2/3, or 1/2 of your original installments, based on your selection.

Are there any options for receiving annuity payments before the end of five contract years?[1]
Yes, our Flexible Annuity Option Rider allows you to receive payments based on your accumulation value **(less any applicable bonus and/or interest earned on that bonus)** anytime after the first contract year but before the sixth contract year over a period certain of 10 to 30 years. Or, at higher attained ages as shown in the Flexible Annuity Option Rider you may request this value in equal installments for a period certain of less than 10 years. Each installment will consist of part principal and part interest. There is no charge for this rider.

What happens if I cancel my contract?
That depends on when you cancel it. This contract is designed for people who are willing to hold their contracts for 10 years (or longer), after which they can cancel their annuity contract without penalty and receive its full accumulation value. If you fully (or partially) surrender your annuity contract before its 10th contract anniversary, the amount you receive will be subject to a surrender charge. This could result in the loss of some or all of your premium bonus, previously credited interest, and a partial loss of principal.

Are there any tax consequences if I withdraw money (or surrender my contract)?
Regardless of whether a withdrawal is penalty-free or subject to a surrender charge and/or other contract penalty, anytime you take a withdrawal from your annuity it may be taxed as ordinary

[1] Not available in all states.

income. This includes partial withdrawals and loans. In addition, any amount you withdraw from your annuity prior to age 59½ may be subject to a 10% federal tax penalty. These taxes and tax penalties may result in a partial loss of principal, as well as a partial loss of any indexed or fixed interest earned previously. Allianz does not provide legal counsel or tax advice, so please consult a tax or legal advisor for further information about tax issues.

Can I add money to my Allianz MasterDex 5 Plus℠ Annuity down the road?
Yes..Additional money (or premium) may be added to your annuity at any time within the first five contract years. The additional premium you pay during a contract year will automatically be credited with a 5% bonus and then placed into an interim interest allocation where it will earn fixed interest – guaranteed to be at least 1.5% – until your next contract anniversary. It will then be allocated to your selected index options and/or the fixed interest option according to your premium allocation percentages.

How will I know how my contract is doing?
You will receive an annual report following each contract anniversary. This report will show your contract's current accumulation value, along with its cash surrender value. The annual report will also reflect any premium payments and any surrenders or withdawals, and will show fixed interest rates, the annual and monthly caps, and spreads for the current contract year.

What happens if I die before annuity payments have begun under my Allianz MasterDex 5 Plus Annuity?
Your beneficiary(ies) will receive the greater of the contract's accumulation value or its guaranteed minimum value. In either case, they can elect to receive a lump-sum payment or payments over the course of five years (or longer).

Are there any other important points I should know about annuities like the Allianz MasterDex 5 Plus℠ Annuity?
If you are purchasing the Allianz MasterDex 5 Plus to replace an annuity you currently own, compare the two products carefully. The benefits and guarantees offered by the two products may be different. Keep in mind that you may incur a surrender charge if you cancel an existing annuity to purchase the Allianz MasterDex 5 Plus. You will also begin a new surrender charge period with your purchase of the Allianz MasterDex 5 Plus. Purchasing the Allianz MasterDex 5 Plus within an IRA or other qualified retirement plan that already provides tax deferral under the Internal Revenue Code results in no additional tax benefit to you. If you are considering the purchase of the Allianz MasterDex 5 Plus in a qualified retirement plan, you should therefore base your decision on its other benefits and features as well as its risks and costs.

I have read the information above. It has been explained to me by the agent. I understand that, during the first 10 contract years, amounts payable under this contract are subject to a surrender charge which may result in a partial loss of premium and the loss of some or all of the bonus and any interest credits earned previously.

I have also received and read the Allianz MasterDex 5 Plus Annuity consumer brochure. I understand that any values shown, other than guaranteed minimum values, are not guarantees, promises, or warranties. I understand that I may return my contract for a full refund within the free look period (shown on the first page of my contract) if I am dissatisfied for any reason.

Owner ______________________________ Date ______________

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

Agent ______________________________ Date ______________

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Lehman Brothers (the "index sponsor") sponsors the Lehman Brothers U. S. Aggregate Index (the "Index"). Direct investment in the Index is not possible. The index sponsor does not sponsor, endorse, sell or promote the Allianz MasterDex 5 Plus Fixed Index Annuity ("the product") or make any representation regarding the advisability of investing in the product. The index sponsor has no responsibility for and does not participate in the management of the product.

Not FDIC insured • May lose value • No bank or credit union guarantee • Not a deposit • Not insured by any federal government agency or NCUA/NCUSIF

ATTACHMENT 9

Allianz Life Insurance Company of North America's Request for No-Action Assurance Relating to Form Requirements Under the Securities Act of 1933, dated June 2, 2006.

Sutherland
Asbill &
Brennan LLP
ATTORNEYS AT LAW
STEPHEN E. ROTH
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JUN 12 2006

June 2, 2006

FOIA CONFIDENTIAL TREATMENT REQUESTED

SEC MAIL PROCESSING SECTION RECEIVED JUN 09 2006 WASH., D.C. 156

VIA HAND DELIVERY

Mr. William J. Kotapish, Esq.
Assistant Director – Office of Insurance Products
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, N.E..
Washington, DC 20004

Re: Allianz Life Insurance Company of North America: Request for No-Action Assurance Relating to Form Requirements Under the Securities Act of 1933

Dear Mr. Kotapish,

On behalf of our client, Allianz Life Insurance Company of North America (the "Company"), we request that the Staff of the Securities and Exchange Commission (the "Commission") confirm that it would not recommend that the Commission take enforcement action if the Company omits certain disclosure requirements from the registration statement on Form S-1 for an annuity contract that credits interest based on changes in a securities index and imposes a market value adjustment (the "EIA Contract").

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I. BACKGROUND

A. Description of Company

The Company is a stock life insurance company incorporated under the laws of the State of Minnesota in 1896. Its operations currently include offering fixed and variable annuities, individual and group life insurance, long-term care insurance and health insurance products. As of December 31, 2005, the Company had assets of approximately $47 billion. The Company is authorized to operate as a life insurance company in forty-nine states and the District of Columbia. Its principal offices are located at 5701 Golden Hills Drive, Minneapolis, MN 55416, (800) 624-0197.

The Company is a subsidiary of Allianz Aktiengesellschaft Holding ("Allianz AG"). Allianz AG is headquartered in Munich, Germany, and has subsidiaries throughout the world.

The Company intends to issue the EIA Contract after registering it with the Commission under the Securities Act of 1933 (the "1933 Act") on Form S-1. However, the Company requests that the Commission Staff confirm that it would not recommend that the Commission take enforcement action if the Company omits certain disclosure requirements from the registration statement on Form S-1 for the EIA Contract. Including all of the Form S-1 requirements in the registration statement for the EIA Contract would result in a prospectus that contains irrelevant and potentially confusing information and would impose significant costs and burdens on the Company, without, in the Company's opinion, increasing investor protection or providing disclosure useful to investors. Instead, these concerns could be alleviated, without impacting the protection of contract owners, by permitting the Company to omit certain disclosure requirements from the registration statement on Form S-1 for the EIA Contract.

B. Description of EIA Contract

The EIA Contract is a modified flexible premium deferred individual annuity regulated under state insurance law and supported by all of the general account assets of the Company. The Company has not established a separate account in connection with the issuance of the EIA Contract. The EIA Contract would provide for a death benefit upon death of the owner during the accumulation phase of the contract, payment of the accumulation value or cash surrender value upon total surrender, and several annuitization payment options (including options guaranteed for the life of the annuitant).

Withdrawals are subject to a withdrawal charge. Contract owners elect either the seven-year withdrawal charge schedule or the ten-year withdrawal charge schedule at the time of application. The withdrawal charge schedule cannot be changed after issuance of the Contract. For the seven-year withdrawal charge schedule, the withdrawal charge is 8.5% at the start of the first contract year and declines to 0% at the start of the eighth contract year. Contract owners who choose this schedule are permitted to make additional purchase payments during the first three contract years. For the ten-year withdrawal charge schedule, the withdrawal charge is 8.5% at the start of the first contract year and declines to 0% at the start of the eleventh contract year. Contract owners that choose this schedule are permitted to make additional purchase payments during the first five contract years. In addition, a bonus of 5% of each purchase payment during the first five contract years (or until the accumulation phase ends, if earlier) is credited to the Contract under the ten-year withdrawal charge schedule. If a contract owner makes any withdrawals, future bonus amounts may be reduced. Bonus amounts previously credited will not be recaptured.

The EIA Contract offers a fixed interest allocation option that provides daily crediting of interest, subject to a minimum guaranteed interest rate. It also offers two indexed allocation options that provide an opportunity to receive annual interest based on changes in an external index during the prior contract year. These indexed allocation options operate identically with the exception of the index used – one uses the Standard & Poor's® 500 Composite Stock Price Index and the other uses the NASDAQ-100 Index® (the "Indexed Accounts").

During the accumulation phase, the contract value in the Indexed Accounts is credited with interest (referred to as "Index Credits") on each contract anniversary. Index Credits are calculated as a percentage of the contract value in the Indexed Accounts on the prior contract anniversary less any partial withdrawals and/or systematic withdrawals taken during the prior contract year (including any applicable withdrawal charge and market value adjustment ("MVA")). The rate used to determine Index Credits is calculated using the monthly point-to-point indexing method. Under this method, the Index Credit rate equals the sum of the index rates on each monthly anniversary day over the contract year (the "Monthly Index Rate"). The EIA Contract does not provide a "floor" of zero on Index Credits. Rather, Index Credits could be negative and thus could operate to invade a portion of principal and previously credited interest.

Index Credits are based on several factors in addition to monthly changes in the NASDAQ-100 or S&P 500, as applicable, including the "Participation Rate" and "Cap." The Participation Rate and Cap limit the amount of positive Index Credits earned in a contract year. The Participation Rate is the amount of any monthly change in the NASDAQ-100 or S&P 500 that is used to determine Index Credits up to the specified Cap. The Participation Rate is expressed as a percentage and applies to both positive and negative Index Credits. For example, if the S&P 500 increases by 2% from one monthly anniversary day to the next, and the Participation Rate is 80%, then the amount of that month's increase in the S&P 500 used in the annual Index Credit formula will be 1.6%. The Cap is expressed as a percentage and applies only to positive Index Credits. The Participation Rate will never be less than 25% and the Cap will never be less than 1%.

Accordingly, the Monthly Index Rate on each monthly anniversary day equals the lesser of: (i) the percentage change in value of the NASDAQ-100 or S&P 500 (as applicable) on a monthly anniversary day compared to the value of the NASDAQ-100 or S&P 500 on the prior monthly anniversary day *multiplied by* the current Participation Rate; or (ii) the current Cap.

As noted above, Index Credits are based in part upon the percentage of gains or losses in the NASDAQ-100 or S&P 500, respectively, without regard to dividends paid by the firms that comprise the Index. The NASDAQ-100 and S&P 500 can increase or decrease daily. However, since Index Credits are applied annually on each contract anniversary, the value in the Indexed Accounts will remain constant during a contract year (assuming no withdrawals during the contract year) and Index Credits will compound on an annual basis only. Because gains and losses are measured as the change in the Monthly Index Rate from one monthly anniversary day to the next, the Contract owner bears the risk that Index Credits will be negative if the Index declines from one monthly anniversary day to the next, even if the Index experienced gains at other times during that period.

An MVA applies to amounts withdrawn from the fixed interest allocation option upon full and partial surrender, death, and annuitization during the surrender charge period. The MVA will adjust the cash surrender value either up or down based on changes in interest rates from the time the contract was issued. Although amounts withdrawn from the indexed allocation options upon full and partial surrender, death, and annuitization are not subject to the MVA, the MVA is applied pro rata and thus will adjust the cash surrender value held in the indexed allocation options as well as in the fixed interest allocation. This MVA is subject to a guaranteed minimum value "floor" (and a maximum value "ceiling") that complies with state nonforfeiture law. The MVA may invade a portion of previously credited interest, but will never operate to invade principal.

The EIA Contract also provides a guaranteed benefit designed to provide a level of protection to Contract owners by preserving certain values after a five-year period. This benefit guarantees that beginning on the fifth contract anniversary, and on each subsequent contract anniversary until annuitization or termination, the Company will increase the accumulation value to equal a "guaranteed value" established on the prior five-year contract anniversary, if the accumulation value is less than this guaranteed value. The guaranteed value is based on purchase payments (not including any bonus) adjusted for withdrawals.

In the future, the Company and/or its affiliates may issue other registered contracts that are substantially similar to the EIA Contract described herein (the "Future EIA Contracts"). These Future EIA Contracts may offer different Indexed Accounts with different crediting strategies.

II. LEGAL DISCUSSION

As explained above, the Company intends to register the EIA Contract with the Commission on Form S-1. The Company requests that the Commission Staff confirm that it would not recommend that the Commission take enforcement action if the Company omits certain Form S-1 disclosure requirements from the registration statement for the EIA Contract that would not serve to enhance investor protection or furnish disclosure that investors would find useful. As discussed below, the Staff has previously provided no-action assurance to insurance companies to modify the requirements of registration statement forms such as Form N-4 and Form S-1 in the context of other insurance product offerings.

A. <u>Modified Form S-1</u>

Requiring the EIA Contract to comply with all of the Form S-1 requirements – requirements that were designed for traditional corporate debt and equity offerings – would result in a prospectus that contains irrelevant and potentially confusing information and would impose significant costs and burdens on the Company, without, in the Company's opinion, increasing investor protection or providing disclosure useful to investors. These concerns could be substantially reduced, while maintaining the protection of investors, by allowing the Company to omit certain Form S-1 disclosure requirements from the EIA Contract registration statement. Pursuant to this approach, contract owners would receive all material disclosure concerning the EIA Contract and the Company.

1. *Annuities Do Not "Fit" Within all of the Form S-1 Requirements*

The current 1933 Act framework applicable to the registration of the EIA Contract on Form S-1 is expensive, unwieldy, ill-suited for continuous offerings of securities, and of fairly limited value to contract owners. Form S-1 was not designed for the registration of annuity contracts like the EIA Contract. Much of the required disclosure that may be material to a purchaser of a more "traditional" security (*i.e.*, a security other than an insurance contract) is simply not material to a prospective purchaser of the EIA Contract. In fact, the presentation of such information in the EIA Contract prospectus may obscure information that is material to a prospective purchaser or confuse investors as to the nature of the security that is being purchased, as the EIA contract is neither a "debt" nor an "equity" security. Rather, the EIA Contract bears more resemblance to a variable annuity contract, which would be registered on Form N-4.

The EIA Contract is an insurance contract and is classified as such under state insurance law and under the Internal Revenue Code of 1986. State insurance law regulates the terms of the EIA Contract, the quality and quantity of corresponding reserves maintained by the Company in connection with its obligations under such EIA Contract, and the overall solvency of the Company. This insurance regulation and these solvency controls support the argument that detailed prospectus information about the Company's business operations is immaterial to an investor.

In fact, the only information that is material to a prospective purchaser of the EIA Contract is disclosure relating to (i) the terms of the contract, and (ii) the Company's ability to satisfy its obligations to the contract owner under the terms of the EIA Contract (*i.e.*, the same type of information available to the purchaser of a variable contract registered on Form N-4). In contrast to the information required to be disclosed on Form N-4 when registering variable annuity contracts, where the focus of "issuer" disclosure is on the separate account, the focus of the disclosure required by Form S-1 is on the insurance company, as the issuer of the contract and the source of contract guarantees.[1] However, disclosure with respect to the Company's history and business, management's discussion and analysis, certain relationships and related transactions, management, and executive compensation, for example, generally is not material to

[1] The Company would note that variable annuity contracts have traditionally had guaranteed features supported by the general account and in the last several years have evolved to offer an array of guaranteed living and death benefits, such as guaranteed minimum death benefits, guaranteed minimum income benefits, guaranteed minimum withdrawal benefits, and guaranteed minimum accumulation benefits.

a prospective purchaser of an EIA Contract. Due to the requirements of Form S-1 (and Regulation S-K), this disclosure must nevertheless be developed, drafted, filed, and disseminated by the Company – at great expense – and with little, if any, benefit to contract owners.

This information is not material to the offering of the EIA Contract for several reasons. First, the Company is in the business of issuing insurance products, including the EIA Contract, and is not seeking to periodically raise capital to finance operations like corporate entities engaged in typical debt and equity offerings. Second, the EIA Contract is not priced or sold like traditional debt and equity securities. Finally, as discussed above, the Company is a highly regulated insurance entity subject to stringent solvency requirements, compliance with which is monitored by state insurance departments.

Omitting certain disclosure requirements from the EIA Contract registration statement on Form S-1 nonetheless would provide contract owners with all material disclosure necessary to evaluate the EIA Contract and the Company. Additionally, to ensure that contract owners are kept fully informed of the Company's solvency status, the Company would provide in the prospectus a toll-free number for contract owners to call to request the Company's audited financial statements free of charge as well as an address at which to send written requests (as explained below, the Company intends to provide the financial statements in Part II of the registration statement). The availability of the Company's annual financial statements should be adequate to address any concern a contract owner may have regarding the Company's ability to meet its contractual obligations, just as the availability of the depositor's annual financial statements has been deemed adequate financial information for investors by the Commission under Forms N-3, N-4, and N-6, the registration forms for variable insurance products.

The Company's request to omit certain disclosure required by Form S-1 includes the proposed placement of its financial statements in Part II of the registration statement, rather than in the prospectus, similar to filings on Form N-4. The Company believes that including its financial statements in the prospectus would substantially increase the length and complexity of the prospectus, without adding any value to a contract owner. The Company's audited financial statements are currently fifty-three pages in length, including footnotes, and the financial statements provide voluminous information about a complex financial services company with a diversified investment portfolio containing assets totaling $47 billion. The Company believes that, as is the case with banks and other issuers of highly regulated "solvency" products, protection of contract owners with regard to the Company's claims paying ability can be better provided through solvency laws, such as state insurance laws, rather than through lengthy and complex financial statement disclosure. State insurance laws, as well as rating agencies, require that the Company hold additional capital in excess of statutory reserve requirements for protection of its general account liabilities. The Company currently maintains excess capital on its EIA Contract liabilities of $2 billion.

Moreover, the Company's general account investments are subject to state investment requirements, and restrictions on permitted investments provide substantial protections assuring that general account guarantees will be honored.[2] State insurance laws also provide protection to contract owners in the event of insolvency in that owners of life insurance policies and annuity contracts receive preference over unsecured creditors with regard to the payment of annuity contract guaranteed amounts.[3] Payment of some or all of annuity contract guaranteed amounts also is assured by state guarantee funds.[4] Finally, the Company's claims paying ability is continuously reviewed by several rating agencies, and the Company believes that this, coupled with comprehensive state insurance regulation, renders the inclusion of financial statements in the prospectus unnecessary to protect investors.

2. *Filing on Form S-1 is Costly and Burdensome*

Drafting a prospectus that meets all of the requirements of Form S-1 would impose significant financial and administrative costs and burdens on the Company that ultimately would be passed on to contract owners in the form of higher contract fees and charges. Complete compliance with Form S-1 would require that the Company's legal and accounting personnel devote substantial time to gathering information on matters such as the Company's management, officers and directors, history, and business, management's discussion and analysis, and executive compensation. This additional disclosure also would result in additional printing and dissemination costs and would require a lengthier review by Commission Staff. Including the financial statements in the prospectus rather than in Part II of the registration statement also would result in a significant increase in printing and dissemination costs.[5] The Company maintains that these additional costs and burdens are disproportionate to any regulatory purpose and the resulting disclosure would not benefit contract owners.

3. *Modification of Form S-1*

Accordingly, the Company requests that the Commission Staff permit it to omit certain disclosure requirements from the EIA Contract registration statement on Form S-1 to ensure that

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[2] For example, Minnesota law requires that: (i) investment in common and preferred stocks in the aggregate cannot exceed 25% of admitted assets (M.S.A Section 61A.28 subd. 6(b)); (ii) investment in non-investment grade bonds be limited to 15% of admitted assets (M.S.A Section 61A.28 subd. 6(f)(iii)); (iii) mortgage loan investments meet principal coverage tests (M.S.A Section 61A.28 subd. 3); and (iv) hedging cannot be "for speculative . . . purposes" (M.S.A Section 61A.28 subd. 9a). In addition, each insurance company is required to have a written investment policy, and compliance with this policy must be reviewed annually by the insurance company's board of directors. M.S.A Section 60A.112.

[3] *See* M.S.A Section 60B.44.

[4] Currently, all fifty states provide guarantee fund coverage of guarantees in annuity contracts of at least $100,000. *See, e.g.*, M.S.A Section 61B.19 subd. 4(2).

[5] Because the Company's financial statements currently total fifty-three pages, inclusion of these statements in the prospectus would double the length of the prospectus.

disclosure is material and not confusing to contract owners. Specifically, the omitted disclosure would be with respect to certain Form requirements pertaining to the Company's history and business, management's discussion and analysis, certain relationships and related transactions, management, executive compensation, and financial statements, which, for the reasons described above, are either confusing or are not material to a prospective purchaser of an EIA Contract.

In particular, the Company requests no-action assurance relating to the omission of the following Form requirements:

- Item 101 of Regulation S-K: A discussion of the general development of the Company's business over the previous five years, a detailed narrative description of the Company's business "done and intended to be done," and financial information about insurer's business segments and geographical areas. However, to ensure that contract owners receive material information concerning the Company and its general account, the Company would include a general description of its business consistent with the level of information required by Form N-4.

- Item 301 of Regulation S-K: Selected financial data for at least the last five fiscal years of the Company.

- Item 303 of Regulation S-K: Management's discussion and analysis ("MD&A") of the Company's financial condition and results of operations (including liquidity, capital resources, and results of operations).

- Item 305 of Regulation S-K: Quantitative and qualitative disclosure about market risk.

- Items 401 and 402 of Regulation S-K: Disclosure regarding the directors and executive officers of the Company, including their background, involvement in certain legal proceedings, transactions with the Company, and executive compensation.

- Item 403 of Regulation S-K: Disclosure regarding security ownership of beneficial owners and management.

- Item 404 of Regulation S-K: Disclosure regarding certain relationships and related transactions.

- Items 504-508 of Regulation S-K: Information about the use of proceeds, determination of offering price, dilution, selling security holders, and plan of distribution. This information is typically omitted from existing registered MVA contract prospectuses as not applicable.

- Item 11(e) of Form S-1: Placement of the financial statements in the prospectus. The Company would, however, propose to include its financial statements in Part II of the registration statement, similar to filings on Form N-4.[6] The Company also would provide in the prospectus a toll-free number for contract owners to call to request the Company's audited financial statements free of charge, as well as an address at which to send written requests.

As a matter of policy, the Commission has recognized that certain disclosure requirements of Form S-1 are not appropriate for specific types of securities.[7] The Company believes that it would be appropriate for it to omit the information called for by the above-listed Items because the information required thereby would not be meaningful to investors and the omission of such would not be inconsistent with the public interest or the protection of investors. The Company believes that the registration statement for the EIA Contract, as modified by the above proposed omissions, would provide all current information that is material and of interest to contract owners. Moreover, the obligation to provide the information called for by the above-listed Items would result in significant costs and burdens on the Company.

B. Precedent

The Staff has previously granted no-action assurance relating to modification of the requirements of Form S-1. In 1996, the Staff stated that it would not recommend enforcement action to the Commission if the Teachers Insurance and Annuity Association of America omitted from the prospectus its full financial statements, and instead provided summary financial information in the prospectus and the full financial statements in Part II of the registration statement on Form S-1.[8] The Staff explained that providing financial information in Part II would streamline the prospectus and be consistent with the Commission's efforts to "encourage registrants to improve the readability of [a] prospectus." The Staff also noted that the "Division of Investment Management may permit the omission of required financial statements or the

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[6] Although newly revised Form S-1 no longer requires that financial statements appear in the prospectus if they are instead incorporated by reference from the registrant's Form 10-K and subsequent Form 10-Q filings, the Company will not be eligible for such incorporation by reference if the Commission grants a requested exemptive order that was submitted simultaneously with this letter.

[7] *See, e.g., Asset-Backed Securities*, 1933 Act Rel. No. 8518, 1934 Act Rel. No. 50905 (Jan. 7, 2005) (Final Rule), 1933 Act Rel. No. 8518, 1934 Act Rel. No. 50905 (Jan. 19, 2005) (Corrections), 1933 Act Rel. No 8518A, 1934 Act Rel. No. 50905A (Dec. 5, 2005) (Technical Amendments), File No. S7-21-04.

[8] *TIAA Real Estate Account*, 1996 SEC No-Act. LEXIS 516 (May 1, 1996). *But see, Assoc. First Capital Corp.*, 1981 SEC No-Act. LEXIS 4307 (Nov. 22, 1981) (denying request to omit information required by Item 17 of Form S-1 due, in large part, to the existence of ongoing rulemaking which proposed amendments to those requirements).

substitution of appropriate financial statements where the omission or substitution is consistent with the protection of investors."[9]

Similarly, the Staff has provided no-action assurance to insurance companies issuing variable annuities to modify the requirements of Form N-4. For example, in 1996, the Commission Staff provided assurance to Cova Financial Services Life Insurance Company and certain affiliates ("Cova") that it would not recommend enforcement action to the Commission if Cova placed accumulation unit tables in an appendix to the prospectus, despite the sequence requirements specified in the instructions to Form N-4, and provided abbreviated information on underlying portfolio companies otherwise required by Item 5(c).[10] The Staff, noting Cova's assertion that the location of the accumulation unit tables at the front of the prospectus "hamper[ed] the readability of the prospectus," stated that the proposal was "consistent with the Commission's efforts to improve prospectuses."

Five years later the Commission Staff provided assurance to Nationwide Life Insurance Company ("Nationwide") that it would not recommend enforcement action if Nationwide disclosed in the statement of additional information classes of accumulation unit value information reflecting combinations of charges between the highest and lowest possible charges otherwise required by Item 4(a) of Form N-4 to be disclosed in the prospectus.[11] Similar to its treatment of Cova's request, the Commission Staff noted that Nationwide's proposal was "consistent with the Commission's efforts to improve prospectuses" and that the "disclosure would provide investors with information . . . in a concise manner that will not distract the investor's attention from the other material information in the prospectus."

Finally, the Staff provided general no-action assurance to insurers in connection with the use of a variable annuity profile used together with a statutory prospectus if an insurer: (1) failed to comply with the sequence requirements of Form N-4; (2) failed to comply with the cover page requirements of Form S-1, S-2, or S-3 in connection with the offering of an MVA feature; and (3) omitted in the statutory prospectus the synopsis of information required by Item 3(b) (noting that "[a]voiding duplication of information is consistent with the policies underlying Form N-4").[12]

The Staff also has provided no-action assurance to other issuers seeking to modify the requirements of various registration statement forms.[13]

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[9] *Id.* (citing 17 C.F.R. § § 210.3-13, 200.30-5(b), & 200.30-1(a)(6)(i)).

[10] *Cova Financial Services Life Insurance Company*, 1996 SEC No-Act. LEXIS 538 (April 15, 1996).

[11] *Nationwide Life Insurance Company*, 2001 SEC No-Act. LEXIS 353 (March 16, 2001).

[12] *National Association for Variable Annuities*, 1997 SEC No-Act. LEXIS 641 (May 30, 1997).

[13] *See, e.g.*, *Aether Systems*, 2005 SEC No-Act. LEXIS 558 (April 26, 2005) (granting no-action relief to omit financial and other information required by Form S-4); *Manulife Financial*

Permitting the Company to omit certain disclosure requirements from the registration statement on Form S-1 for the EIA Contract would be consistent with the Staff's objective to improve prospectuses by fashioning a prospectus that contains information that is material and not extraneous, duplicative, or overwhelming to contract owners and that is consistent with plain English initiatives.

III. Conclusion

In view of the foregoing, the Company respectfully requests that you advise us that the Staff would not recommend that the Commission take any enforcement action if the Company omits certain disclosure requirements from the registration statement on Form S-1 for the EIA Contract, as described above. For the Staff's reference, a draft Form S-1 registration statement describing the EIA Contract and omitting the disclosure called for by the Items listed previously in Section II.A.3. is attached hereto.

Additionally, the Company respectfully requests that the Commission Staff concur in its view that the requested relief should apply not only with respect to the EIA Contract, but also to any and all subsequent Future EIA Contracts issued by the Company and/or its affiliates, where the contractual terms and conditions of the Future EIA Contracts and the rights and duties of the Company or its affiliates thereunder are substantially similar to the EIA Contract described herein.

IV. Request For Confidential Treatment

Public availability of this request would have material adverse consequences for the Company. Accordingly, a copy of this letter is also being sent to the Commission's Freedom of Information Act Office, and the Company respectfully requests, in accordance with 17 C.F.R. § 200.83, that the Commission accord confidential treatment to this request, which has been numbered ALIC001 through ALIC0079, until after the Form S-1 registration statement is made public, or 120 days from the date of this letter, whichever first occurs. Accordingly, unless the

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Corporation, 2005 SEC No-Act. LEXIS 646 (March 15, 2005) (granting no-action relief to omit financial statements required by Forms F-3 and F-9); *New York Stock Exchange*, 1998 SEC No-Act. Lexis 770 (August 12, 1998) (granting no-action relief to omit information from Form 8-A); *ITT Corporation*, 1996 SEC No-Act. LEXIS 895 (December 6, 1996) (granting no-action relief to include information in the prospectus that does not conform with Sections 501 and 502 of Regulation S-K); *Commercial Credit Co.*, 1981 SEC No-Act. LEXIS 3283 (March 17, 1981) (granting no-action relief to omit certain exhibits required by Regulation S-K on Form S-7). *But see, Old Nat'l Bancorp*, 1977 SEC No-Act. LEXIS 1989 (August 8, 1977) (denying no-action request to omit financial statements required by Form S-8).

Commission intends to deny a request for access on other grounds, please promptly notify Stewart Gregg at:

Allianz Life Insurance Company of North America
5701 Golden Hills Drive
Minneapolis, MN 55416
(763) 765-2913

of any request under the Freedom of Information Act seeking access to this letter during this time period, to enable the Company to substantiate the grounds for confidential treatment.

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If you have any questions, please feel free to contact the undersigned at 202.383.0158 or Mary E. Thornton at 202.383.0698. Thank you for your attention to this matter.

Sincerely,

Stephen E. Roth

Stephen E. Roth

cc: Stewart D. Gregg, Esq.
Mary E. Thornton, Esq.
SEC FOIA Office