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Ms. Florence E. Harmon
Acting Secretary
U. S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 2049-1090

Re: Indexed Annuities and Certain Other Insurance Contracts (File No. S7-14-08)

Dear Ms. Harmon:

We are submitting this letter on behalf of AXA Equitable Life Insurance Company, Hartford Financial Services Group, Inc., Massachusetts Mutual Life Insurance Company, MetLife, Inc. and New York Life Insurance Company (the "Companies"). The Companies firmly support the Commission's efforts to clarify its jurisdiction over equity indexed annuities, by requiring registration under the federal securities laws of these unique products, and provide below supporting legal analysis for this conclusion.[1] The Companies believe that Rule 151A as proposed is overly broad, however, and provide below for Commission consideration suggested modifications to the proposed rule that focus specifically on equity indexed annuities.

Equity indexed annuities differ in kind from traditional fixed annuities that qualify for exclusion from the federal securities laws.[2] Unlike traditional fixed annuities, equity indexed annuities include as a basic defining component an opportunity for the owner to participate in the performance of the equity markets by application of a contractually defined formula.[3]

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1 *See Indexed Annuities and Certain Other Insurance Contracts*, SEC Rel. Nos. 33-8933 and 34-58022 (June 25, 2008).

2 Section 3(a)(8) of the Securities Act of 1933 ("1933 Act") applies to "[a]ny insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory or the United States or the District of Columbia." Insurance products that satisfy Section 3(a)(8) are excluded from the 1933 Act Section 5 registration obligations as well as from the general antifraud provisions of the 1933 Act and the Securities Exchange Act of 1934. *See, e.g.*, H.R. Rep. No. 85, 73d Cong., 1st Sess. 15 (1933); *Definition of "Annuity Contract or Optional Annuity Contract"*, SEC Rel. No. 33-6558 (Nov. 21, 1984) ("Rule 151 Proposing Release").

3 Typical equity indexed annuities contractually bind the issuing insurance company to periodically credit the contract with an amount equal to the performance of a stated equity market index, such as the S&P

Although the formula is known by the owner in advance, the return to the owner is known only after the fact. This potential to participate in prospective market performance is critical to the sale of equity indexed annuities – investors buy these products because of the opportunity to participate in the market – which requires an understanding of what the index is, how it works and how the contractual formula operates in order for an investor to make an informed decision to buy and keep an equity indexed annuity. Because fixed annuities, in contrast, guarantee interest at rates stated in advance, a purchaser knows what the relative risks and rewards are in deciding whether to make an initial purchase, make additional payments and/or exchange into another product. It is well within the Commission's jurisdiction to clarify that these unique distinguishing features of equity indexed annuities justify their registration under the federal securities laws. An analysis of Section 3(a)(8) precedents fully supports this conclusion.

Section 3(a)(8)

The Section 3(a)(8) exclusion for insurance products involves a balancing of factors developed by federal courts and the Commission that relate primarily to (i) the assumption of investment risk by the investor and (ii) the nature of promotional and marketing efforts.[4] These precedents also make clear that the determination of whether the Section 3(a)(8) exclusion applies involves a balancing of these factors, such that the assessment of whether a

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500 Index, over the prior period based on a complex indexing formula that varies by contract. The Commission has described the types of indexing formulae typically in use, including the "look back" or "high water mark" method, the "low water mark" method and the "point to point" method, which may further be subject to a specified participation rate, a cap or a floor or limits on the amount that the investor can withdraw in certain time frames. *Equity Index Insurance Products*, SEC Rel. No. 33-7438 (August 20, 1997) ("Concept Release"). In any event, the return to the investor is directly related to the performance of the stated equity market index, subject to the various contractual terms.

4 *See, e.g., SEC v. Variable Annuity Life Ins. Co. of America,* 359 U.S. 65 (1959) ("VALIC"); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) ("United Benefit"); and Brief for the United States as *Amicus Curiae*, *Variable Life Ins. Co. v. Otto*, 486 U.S. 1026 (May 23, 1988)(No. 87-600). An additional factor, the degree of mortality risk assumed by the insurance company, also may weigh in, or may be integrated with an assumption of investment risk, to tip the balance. *See, e.g., United Benefit*; *Helvering v. LeGierse*, 312 U.S. 531 (1941); Kroll and Cohen, *The Insurance-Security Identity Crisis*, Geo. Wash. L.Rev., Vol. 46, No. 5 at 802 (Aug. 1978). *Compare General Statement of Policy Regarding Exemptive Provisions Relating to Annuity and Insurance Contracts*, SEC Rel. No. 33-6051 (April 5, 1979) ("Release 6051") *with* Rule 151 under the 1933 Act. Typical mortality guarantees in annuity contracts may include guaranteed annuity purchase rates based on mortality assumptions at the time of contract issuance, guaranteed betterment of rates provisions, and guaranteed return of purchase payments upon death.

type of product falls within the exclusion involves an overall determination of the cumulative impact of these factors.[5]

Investment Risk. In *VALIC* and *United Benefit* (and their progeny), the courts' analysis focused on a form of investment risk that is inherent in all annuity contracts – the potential for gains or losses on the investment by the insurer of the purchaser's premium payments. This form of risk is essentially a zero-sum game – the amount of risk assumed by one party effectively relieves the other party of an equal amount of risk. Implicit in those cases is the notion that a traditional fixed annuity is the benchmark for the allocation of this risk between the insurer and the purchaser (with the insurer retaining the risk that it will have to pay the guaranteed amounts even if the results of the invested premiums are not sufficient to support such payments), and that this allocation shifts along a continuum with a typical variable annuity at the other end (with the purchaser bearing the risk that return on the invested premiums may not meet his or her expectations).

Equity indexed annuities do not diverge fundamentally from traditional fixed annuities with respect to this continuum that emphasizes risk of loss of the purchaser's premium payments. However, this traditional analysis does not take into account one of the key differences between fixed annuities and equity indexed annuities. Equity indexed annuities add an additional layer of investment risk – the potential for additional gains, above the guaranteed minimum, based on the performance of an equity index. In the typical equity indexed annuity, this risk is borne almost entirely by the purchaser.[6] The insurer's risk is limited by the product's complex structure (*e.g.*, the interest-crediting methods, caps, participation rates, spread deductions and similar features). It is because of the allocation of this risk (combined with the marketing aspects discussed in the following section) that equity indexed annuities should not be able to rely on the Section 3(a)(8) exclusion.

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5 *Grainger v. State Sec. Life Ins. Co.*, 547 F.2d 303, *rehearing denied*, 563 F.2d 215 (5th Cir. 1977), *cert. denied*, 436 U.S. 932 (1978) ("Grainger"). *See also Release 6051*. Thus, for example, life insurance contracts, in which the insurer provides substantial mortality guarantees, may involve a lower assumption of investment risk by the purchaser under Section 3(a)(8) than a comparable annuity contract with lesser mortality guarantees. *See, e.g., Olpin v. Ideal National Ins. Co.*, 419 F.2d 1250 (10th Cir. 1969), *cert. denied*, 397 U.S. 1074 (1970).

6 The Commission stated in adopting the Rule 151 safe harbor under Section 3(a)(8) that "an insurer which uses an index feature externalizes its discretionary excess interest rate, and thus shifts to the contractowner all of the investment risk regarding fluctuations in that rate." Definition of Annuity Contract or Optional Annuity Contract, SEC Rel. No. 33-6645 (May 29, 1986) ("Rule 151 Adopting Release"). Although the Commission determined "to permit insurers [relying on Rule 151] to make limited use of index features in determining the excess interest rate," this was in the context of setting rates that are prospectively guaranteed, and the formulas under which equity indexed annuities determine excess interest would not be considered limited use under this analysis.

This conclusion is consistent with existing precedent. The United States Supreme Court in *United Benefit* stated that "while the guarantee of cash value based on net premiums reduces substantially the investment risk of the contract holder, the assumption of an investment risk cannot by itself create an insurance provision under the federal definition. . . . The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized."[7] Although in *United Benefit* the insurance company shouldered some investment risk in the form of certain minimum guarantees,[8] the Court found that the "insurer is obligated to produce no more than the guaranteed minimum at maturity, and this amount is substantially less than that guaranteed by the same premiums in a conventional deferred annuity contract."[9] Indeed, the Court concluded that, "[i]nstead of promising to the policyholder an accumulation to a fixed amount of savings at interest, the insurer promises to serve as an investment agency and allow the policyholder to share in its investment experience."[10] Similarly, in the context of an equity indexed annuity, the insurer promises to allow the owner to share in the investment experience of the specified equity market index.

The positions enunciated in federal court cases amount largely to fact-intensive line drawing, distinguishing those insurance products lacking sufficient minimum guarantees to place significant investment risk on the insurance company[11] from those cases in which an

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7 *United Benefit* at 211 (citations omitted).

8 The optional annuity contract, known as the Flexible Fund Annuity, guaranteed, prior to annuitization, that the cash value would never be less than 50% of net premiums paid in the first year gradually increasing to 100% of net premiums paid after 10 years. *Id.* at 205.

9 *Id.* at 208. By the same token, equity indexed annuities typically guarantee only 87.5% of principal based on amendments to state non-forfeiture laws specifically intended to provide equity indexed annuities greater leeway than traditional fixed annuities. *See, e.g., NAIC Model Laws, Regulations and Guidelines* 805-1, § 4C (allowing equity indexed annuities to reduce their minimum guaranteed interest by up to 100 basis points).

10 *Id.* At maturity, the investor had the option of receiving the net premium guarantee or the value of a Flexible Fund in which the insurer invested net premiums in a pool primarily of common stocks. The Court's decision also appeared to be influenced by the extent to which the contract was marketed "on the prospect of 'growth' through sound investment management." *Id.* at 211. The Section 3(a)(8) issues raised by marketing are discussed below.

11 *See, e.g., Peoria Union Stock Yards Co. v. Penn Mut. Life Ins. Co.*, 698 F.2d 320 (7th Cir. 1983) (a "group deposit administration contract" was a security because the minimum guaranteed fixed interest (a declining rate from 7½% to 3% on deposits in the first three years of the contract and then no guarantee on new deposits after the contract's third year).

insurance company has assumed sufficient investment risk to support coverage under Section 3(a)(8).[12]

One important factor emphasized by the courts in this context is whether the guarantees provided are announced on a prospective basis (in the case of the Commission's safe harbor Rule 151 for a year or longer) or are determined retrospectively, after a given period of time has concluded. The court in *Home Life*, for example, determined that the annuity in that case was not a security because the purchaser had certainty as to amounts of interest and excess interest that would be paid under the annuity for the specified period.[13] In reaching this conclusion, the court contrasted the instruments in *VALIC* and *United Benefit* in which "the buyer paid money; the seller held it for a time, *after which it announced the rate of interest to be credited*. The *ex ante* uncertainty about that rate made the "annuity" look like a mutual fund, with the seller supplying only investment advice. Home Life, by contrast, announced the annual interest rate in advance."[14]

Although no court has applied a "bright-line" test specifying the minimum guarantees necessary in an insurance contract to satisfy the investment risk factor in a Section 3(a)(8) analysis, it is generally decisive that the guarantees be identified prospectively – which is typically not true of equity indexed annuities. The *Home Life* court conceded that no annuity transfers all investment risk to the insurance company, and that an annuity purchaser does assume some level of risk that the insurance company's investments will under perform the amounts the insurance company has guaranteed under the annuity contract. The insurance company may nonetheless assume significant investment risk, as opposed to the policy owner, if the policy owner has some certainty as to the minimum and excess rates of interest that will be credited in advance of an upcoming contract year. The *Home Life* court contrasted this decision with earlier decisions where credited rates of excess interest were not

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[12] *See, e.g., Associates in Adolescent Psychiatry v. Home Life Ins. Co.*, 941 F.2d 561 (7th Cir. 1991), *cert. denied*, 502 U.S. 1099 (1992) ("Home Life").

[13] Home Life's Flexible Annuity guaranteed interest at 7% during the first year, declining to 4% in the annuity's sixth year and thereafter as well as specified excess interest rates declared in advance of application. *Id.* at 564.

[14] *Home Life* at 567(emphasis added). The court further stated: "At the beginning of each policy year Home Life would declare a rate of return for the coming year. The terms of the Flexible Annuity left the purchaser free (a) to withdraw all funds and invest them elsewhere, if dissatisfied with the rate; (b) to leave the funds with Home Life and add nothing to them; and (c) to make additional purchases. [The owner] knew what rate of return it would earn for the next year not only before it made its initial contribution but also prior to deciding to "roll over" its investment each year thereafter. Had it found the declared rate unsatisfactory, it was free under the terms of the contract to take its money and go elsewhere." *Id.*

declared in advance, giving those products the character of a mutual fund and the insurance companies the character of sellers of investment advice.

Marketing. The courts and the Commission have also established that the manner in which the contract is marketed and sold may not emphasize the possibility of participation in market performance and instead must focus on the safety and security of the insurance contract. Marketing materials for fixed annuities are geared to appeal to purchasers primarily on the insurance basis of stability and security and not the investment prospect of sharing in the growth of the stock market. Purchasers are typically told that interest rates above the lifetime minimum may be reset in the future. These rates generally are set by the company based on its expectations for future investment earnings, operating expenses, mortality, taxes, competitive factors and the like. In the case of equity indexed annuity contracts, in contrast, investment return based on the performance of an equity market index is an explicit term in the annuity contract, and it is precisely the possibility of participation in this performance, as held out by the issuer, that attracts purchasers to equity indexed annuities.

The Supreme Court, in finding that the annuity contract in *United Benefit* did not satisfy Section 3(a)(8), noted that "[t]he test . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of [the 1933 Act] it is not inappropriate that promoters' offerings be judged as being what they were represented to be."[15] Lower federal courts have followed *United Benefit* in finding that promotional efforts that emphasized the investment features of an insurance product tilted the balance toward a security, not insurance.[16] An investor's ability to participate in the market growth made available by an equity indexed annuity is a key contractual feature. No meaningful marketing of equity

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15 *United Benefit* at 211 (*quoting SEC v. Joiner Leasing Corp.*, 320 U.S. 344, 352-53 (1943) ("Joiner")). The *United Benefit* Court noted that "[United Benefit's] sales brochure describes the plan as featuring 'a method of accumulation modernized to keep pace with today's living . . . and a chance to share in the growth of the country's economy.' At the same time it is claimed that the plan 'combines this new method of accumulation with the time-tested advantages of a lifetime annuity . . . a savings and accumulation plan that guarantees a lifetime income at maturity.' *United Benefit* at 204, n. 3.

16 *See, e.g., Joiner*; *Grainger*; *Berent v. Kemper Corp.*, 973 F.2d 1291 (6th Cir. 1992). Conversely, promotional materials that emphasized certain insurance aspects, such as product features designed for long-term retirement or estate planning or death benefit coverage, tilted the balance away from a security toward insurance. *See, e.g., Berent* at 443 (noting that marketing aspects of life insurance products, such as the product's single premium, death benefit, and estate planning advantages, emphasized the insurance aspects, rather than the investment aspects, of the life insurance product).

indexed annuities can occur without express reference to and explanation of the potential for participation in the performance of the specified equity index.[17]

The Commission's safe harbor Rule 151 codifies its views on marketing as an important element of the safe harbor, and requires that an annuity contract not be marketed "primarily" as an investment.[18] In proposing Rule 151, the SEC stated that the term "primarily" addresses, among other things, whether substantial emphasis is placed on discretionary excess interest, the possibility of future interest or other investment-oriented features of an annuity contract or the interchangeability of an annuity contract with other tax-deferred investments.[19] By nature, equity indexed annuities must include as an important marketing component an emphasis on the link to equity participation through the contractual indexing formula. These contracts are marketed to meet certain investors' desires to participate in the equity markets, and the marketing materials would of necessity highlight those features.

Conclusion. In the view of the Companies, the Commission's efforts to specifically subject equity indexed annuities to registration under the federal securities laws is a welcome clarification of the law. The various ways in which equity indexed annuities participate in the experience of a market index are complex and profoundly confusing to unsophisticated investors.[20] Although equity indexed annuities provide certain investment guarantees, they are fundamentally linked to investment performance of a market index, and it is this potential participation in market performance that is the unique inducement to the sale of an equity indexed annuity over a traditional fixed annuity.

Suggested Revisions to Proposed Rule 151A

The Companies are concerned with several aspects of the proposal that create ambiguities and potentially reach traditional fixed insurance products, which in the views of

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17 As stated by one court, the insurance company's "argument directly under the statute depends on its assertion that the guaranty of return here requires calling the instrument insurance under [Section] 3(a)(8) even if the *prospect of 'excess' interest is a principal inducement* to purchase this particular instrument." *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127, 1142 (7th Cir. 1986), *rev'd on rehearing,* 814 F.2d 1140, 1142 (1987), *modified* (1987), *cert. denied,* 486 U.S. 1026 (1988) ("Otto") (emphasis added).

18 Rule 151(a)(3).

19 *Rule 151 Proposing Release* at 5. The Commission stated in adopting Rule 151 that such an approach would likely fail the marketing test. *Rule 151 Adopting Release* at n. 47.

20 *See e.g.*, Concept Release; FINRA Investor Alert, Equity-Indexed Annuities—A Complex Choice, http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/AnnuitiesAndInsurance/p010614 (last visited September 3, 2008).

the Companies fall squarely within the statutory exclusion from the 1933 Act for annuity contracts. The proposal would require 1933 Act registration for any annuity contract under which (a) amounts payable by the issuer are calculated, in whole or in part, by reference to the performance of a security, including a group or index of securities and (b) amounts payable by the issuer are more likely than not to exceed the amounts guaranteed under the contract.

As currently drafted, the first part of this proposal could potentially encompass traditional annuity contracts, including those that fall within the existing Rule 151 safe harbor.[21] By covering contracts with amounts payable "calculated in whole or in part by reference to the performance of a security, including a group or index of securities," the proposal is overbroad. This language could be interpreted to include traditional contracts, under which insurers prospectively declare excess interest rates by reference to the expected future yield of certain general account investments or specific fixed income securities or indexes.

The types of contracts the Companies believe should be covered by this first part of the proposals are those annuity contracts with contractual provisions directly tying values and payments to the performance of a specified equity market index, with the explicit expectation that contract values will benefit from positive performance of the index. In this regard, the Companies are distinguishing between equity indexes, which would be covered by the Rule, and other types of fixed indexes, which would not specifically be included. The signature element of an equity indexed annuity contract is the contractual promise that the purchaser will participate in market experience, as represented by an equity securities index such as the S&P 500 Index, on a retroactive basis rather than depend on the issuing insurance company to prospectively adjust contractual interest rate guarantees as market conditions change over time.[22]

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[21] In adopting Rule 151 the Commission determined that contracts with excess interest rates set by reference to the performance of a specified securities index could rely on the safe harbor exclusion from the 1933 Act and permitted insurance companies to "specify an index to which it will refer, no more often than annually, to determine the *excess rate that it will guarantee under the contract for the next 12-month or longer period*. Once determined, the rate of excess interest credited to a particular purchase payment or to the value accumulated under the contract must remain in effect for at least the one-year time period established by the rule." *Rule 151 Adopting Release* at 11 (emphasis added) (footnotes omitted). As noted, the Commission permitted the use of an index solely to set prospective rate guarantees and not for purposes of the retroactive payment calculations used in equity indexed annuities.

[22] It is irrelevant in this regard whether the insurance company hedged its market exposure or otherwise managed the risk it retained.

Because of the fundamental tie between a contractual promise of this nature and the manner in which the contract must be sold and promoted, the Companies believe marketing is not a separate consideration. These products inherently involve a discussion of the contractual index formula and its performance in different market conditions. Consistent with the precedents discussed above, participation in the equity market index is a "principal inducement" to the sale of an equity indexed annuity, and, by definition, their sale emphasizes "discretionary excess interest, the possibility of future interest or other investment-oriented features" contrary to reliance on Section 3(a)(8).

An alternative to the language of Rule 151A as currently proposed would be to clarify that Section 3(a)(8) is not available for an annuity contract or optional annuity contract, which does not otherwise satisfy the conditions set forth in Rule 151, and:

> (A) under which amounts payable by the issuer under the contract are calculated, in whole or in part, by contractual reference to the performance of an equity security, including a group or index of equity securities; and
>
> (B) for which the amount payable in (A) above is determined retroactively (*i.e.*, determined by the actual performance of the equity security or group or index of equity securities, even if the formula is determined in advance).

This language would limit Rule 151A to those contracts presenting the greatest risks to purchasers and posing the most significant complexities in the sales process. All other annuities that do not qualify for the Rule 151 safe harbor would continue to be measured against the statutory articulation in Section 3(a)(8).

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The Companies appreciate the opportunity to provide these comments on the proposals.

Sincerely,

Diane E. Ambler

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cc: The Honorable Christopher Cox, Chairman
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
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