2251

MEMORANDUM

October 23, 2008

To: File No. S7-14-08

From: James R. Burns
Office of Commissioner Kathleen L. Casey

Re: Indexed Annuities and Certain Other Insurance Contracts
Release No. 33-8933

On October 20, 2008, Commissioner Kathleen L. Casey and James R. Burns, Counsel to the Commissioner, met with Eric Marhoun, Senior Vice President and General Counsel, Old Mutual Financial Network, and Tom McDonald of Baker & Hostetler LLP. The participants discussed the Commission's proposed Rule 151A.

At the meeting, Old Mutual Financial Network provided various documents relating to proposed Rule 151A, including a 15-page handout titled "Old Mutual's View of SEC Rule 151A." Copies of the documents are attached to this memorandum.

Attachments

OLD MUTUAL
INVEST INSURE INNOVATE

A PRESENTATION TO:

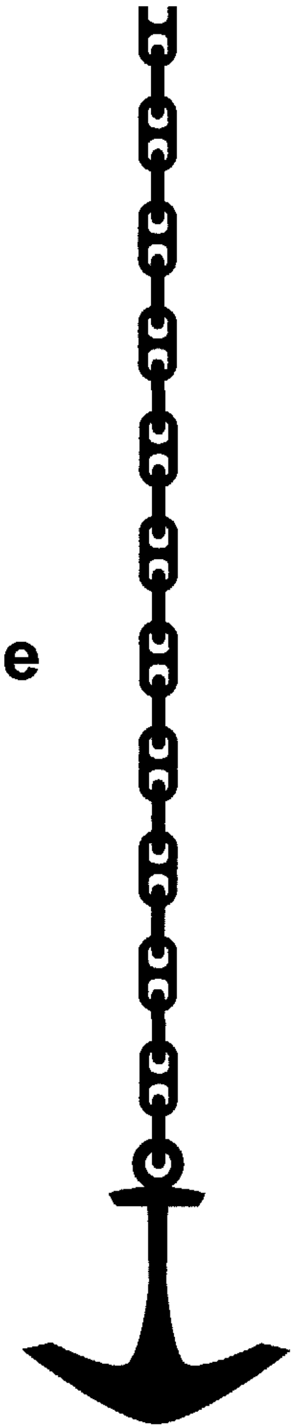
Hon. Kathleen Casey
Commissioner, SEC

PRESENTED BY:

Eric Marhoun

October 20, 2008

Old Mutual's View of SEC Rule 151A



Executive Summary

- Rule 151A is unnecessary and overly burdensome – goes beyond marketing to seniors.
- Rule 151A ignores the efforts of State Insurance Commissioners in addressing sales practices.
- Rule 151A is so broadly written that it would apply to all annuities, and ultimately all interest-crediting life insurance.
- Rule 151A would have an adverse impact upon Old Mutual Financial, its 400 employees and 30,000 independent producers.

OLD MUTUAL
INVEST INSURE INNOVATE

Background on Annuities

- A leading retirement product offered by life insurance companies offering:
  - Guaranteed retirement savings and asset protection
  - Probate efficiencies
  - Guaranteed income options like annuitization
- Benefits of FIAs:
  - Guaranteed accumulation with no up-front sales charge
  - Tax deferral
  - Withdrawal or annuitization rights
- Regulated by state insurance departments. 3 basic types: FIAs, declared rate and VAs.
- Growth from @$4B in 1998 to $25B in 2007; 10% of annuity sales

OLD MUTUAL
INVEST INSURE INNOVATE

Overview of Rule 151A

- Proposed by the SEC without any real warning after over a decade of non-action by the SEC other than 2005 voluntary information request.
- Imposes an unprecedented two-prong test that could be read to apply to nearly all non-variable annuities and, ultimately, to all interest-crediting life insurance policies.
- Applies to insurance products which have been regulated as insurance products since their inception almost 13 years ago.
- Ignores State Insurance Department suitability regulation developed over the past 5-6 years applicabl to FIA sales practices (and prior Unfair Practices

Fixed Index Annuities ***not*** Securities

- Fixed Index Annuities (FIAs) are fixed annuities and have no market risk.
- The 151A release incorrectly equates the purchase of an FIA with an investment in a market index.
- The only difference between a traditional declared rate annuity and an FIA is the manner in which annual interest is calculated.
- In both cases, the full contract value, including premium plus interest credited in all prior years, is ***not*** exposed to ***any*** market risk.
- The consumer cannot lose money due to the market.

OLD MUTUAL
INVEST INSURE INNOVATE

Comparison of Annuities

	Declared Rate Annuity	Fixed Index Annuity	Variable Annuity
Guarantee of premium and minimum interest	✓	✓	
Annual interest at rates declared by the insurer	✓		
Annual interest linked to an external index		✓	
Consumer bears Market Risk			✓
Tax-deferred growth	✓	✓	✓
No up front sales charges or annual fees	✓	✓	
Penalty-free 10% annual withdrawals starting in yr 2	✓	✓	✓
Penalty-free systematic interest withdrawals	✓	✓	✓
Surrender charges apply for withdrawals above 10%, waived at death	✓	✓	✓
Additional liquidity upon nursing home confinement or terminal illness or unemployment	✓	✓	

Why Consumers Buy FIAs

- The SEC 151A release incorrectly concludes that FIAs are marketed and purchased primarily for market gains.
- FIAs are purchased primarily for safety of premium with the potential for additional credited interest.
- FIAs offer consumers the opportunity to earn a somewhat higher interest rate than would be paid on a declared rate product.

Consumers Bear *no* Investment Risk

- The 151A release mistakenly states that an FIA purchaser assumes investment risk comparable to a variable annuity or mutual fund. **This is incorrect and has led to a totally unprecedented proposed Rule with 2-prongs having no basis in law.**
- FIA investment risk is limited to fluctuations in annual interest (similar to declared rate annuity) subject to a guaranteed minimum.
- Prong 1 – reference to a Security: Many insurance and bank products not regulated as securities have fluctuating levels of annual interest – including e.g. indexed certificates of deposit.
- Prong 2 – more likely than not in excess of guarantee: Many insurance products not regulated as securities provide for "excess value" above guaranteed minimums.

Insurer Investment Risk

- Fixed annuity insurers manage their "general account" securities to fund guaranteed FIA contract values.
- None of the risk of loss on general account securities is passed through to consumers.
- Variable annuities are "separate account" products where all investment experience of securities within the account is passed through to consumers, whether gain or loss.

An Unnecessary Layer of Regulation

- Insurance Producers are already licensed and regulated by State Insurance Commissioners.
- Insurance Companies *as issuer* have duty to develop system of supervision with regard to annuity suitability.
- Insurance regulations impose disclosure and advertising requirements upon all annuity sales.
- Insurers apply suitability standards nationally.

Insurance Regulation of Sales Practices

- The 151A release incorrectly states that the main focus of state insurance regulation is insurer financial solvency. **(Strongly disputed at SEC Senior Summit.)**
- State insurance regulation also covers (with some variation by state):
  - Annuity disclosure requirements
  - Suitability reviews
  - "Free-look" periods
  - Advertising
  - Unfair trade practices
  - Regulation of "replacements", or exchanges of annuities
  - Market conduct reviews of insurers
  - Levels of consumer guarantees in annuities/surrender charges
  - Agent licensing and training (specific FIA training in some states)
  - Insurance agent penalties for violations of sales rules

Complaints

- The 151A release states – with no evidence -- that complaints and abusive FIA sales practices are sharply increasing.
- NAIC complaint data shows fewer complaints regarding FIAs than VAs.
- NASAA maintains no complaint data that we (or others) have been able to locate.
- The NBC Dateline segment on FIAs featured only one actual consumer.

OLD MUTUAL
INVEST INSURE INNOVATE

Insurance Regulation is Working

- The 151A release incorrectly states that fraud and abuse in sales to the elderly are closely linked to FIAs.
- Securities regulation is no more effective than state insurance regulation in protecting seniors from unscrupulous sales practices in sales of financial products.
- State insurance regulators are implementing new and enhanced protections for seniors, just as securities regulators are.
- SEC proposal will derail progress on sales practice regulation.

OLD MUTUAL
INVEST INSURE INNOVATE

Old Mutual

- No Old Mutual FIA policyholder has ever lost a dime of contract value as a result of market volatility.
- Old Mutual conducts suitability reviews of all sales in all states.
- Old Mutual has a complaint ratio of less than 0.2% of all FIA contract-holders.

Additional Considerations

- Reach out to the NAIC, particularly the Annuity Suitability Working Group chaired by the Wisconsin Commissioner.
- Coordinate suitability enhancement efforts with the Annuity Working Group of which FINRA is a member.
- Rule 151A would have unintended consequences which have not been explored:
  - Diminish Guarantee Fund coverage for FIAs: "any policy or contract under which risk is born by the policyholder."
  - Diminish availability of product offerings in rural areas due to limitations imposed by OSJ requirements.

OLD MUTUAL.
INVEST INSURE INNOVATE

Old Mutual Financial Network

August 4, 2008

The Honorable Ralph Tyler
Commissioner
Maryland Insurance Administration
525 St. Paul Place
Baltimore, MD 21202

RE: Securities and Exchange Commission ("SEC") Proposed Rule 151A

Dear Commissioner Tyler:

On behalf of Old Mutual Financial Network ("Old Mutual," the marketing name for OM Financial Life Insurance Company and OM Financial Life Insurance Company of New York), one of the largest issuers of indexed annuity contracts in the U.S., I would like to express our appreciation for the opportunity to address with you our concerns regarding recently proposed SEC Rule 151A. As you are aware, on June 25, 2008, with virtually no forewarning and no prior consultation with the life insurance industry, the SEC announced this new and far-reaching proposal to reclassify indexed annuity contracts as securities rather than state regulated insurance contracts. If Rule 151A is adopted as proposed, it would have serious adverse implications for Old Mutual, the entire fixed annuities industry and purchasers of indexed annuity contracts. For the reasons discussed below, Old Mutual believes that the indexed annuity contracts it offers are insurance contracts, not securities, and that proposed Rule 151A is an unworkable rule that is inconsistent with the language of the Securities Act of 1933 (the "Securities Act"), Congressional intent to preserve for states the regulation of insurance and relevant judicial precedent.

Each indexed annuity contract Old Mutual offers is a fixed annuity contract that provides traditional annuity guarantees of principal and interest through a fixed interest crediting option, and various interest crediting options that credit interest based on formulas that take into account movements in either the S&P 500 Index or the Dow Jones Industrial Average. Old Mutual assumes substantial investment risks through these and other guarantees under the contracts. Specifically, Old Mutual provides a state nonforfeiture guarantee under each contract (guaranteed minimum value of 100% or 87.5% of premiums accumulated at interest rates between 1% and 3%) and a guarantee of all previously credited interest under the contract. Old Mutual assumes a meaningful mortality risk through the guarantee of a death benefit and the availability of annuity payment options with fixed purchase rates. These are the types of guarantees that courts and the SEC have historically looked to in distinguishing contracts of insurance from securities.

Unlike a variable annuity contract where a contract owner's interest is limited solely to a pro rata interest in a segregated pool of assets and subject to the performance of those assets, the guarantees under the contracts are supported by the general account of Old Mutual, but are not dependent upon the performance of assets held in the general account. Under the contracts, Old Mutual credits rates of interest declared in advance for specified periods and indexed rates of interest pursuant to prescribed formulas without reference to the performance of assets held by the Company. As such, unlike a variable annuity contract that transfers all investment risk to the contract owner, Old Mutual bears substantial investment risk under its indexed annuity contracts.

Consistent with well-established judicial and SEC interpretations that provide guidance for determining whether contracts of insurance are marketed as securities, Old Mutual has invested substantial resources to ensure that its marketing program emphasizes the insurance aspects of its indexed annuity contracts to ensure they are not marketed as securities. For the reasons we have noted, and as discussed in more detail in the memorandum Old Mutual provided Mr. Keith Carpenter, Special Counsel, SEC, dated August 30, 2005, a copy of which was forwarded to your attention last week, Old Mutual believes its indexed annuity contracts are insurance contracts, and therefore, the Company is eligible to rely upon the specific exclusion from registration and regulation under the federal securities laws available to insurance contracts set forth under Section 3(a)(8) of the Securities Act, which exempts:

> Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any state or territory of the United States or the District of Columbia.

Notwithstanding the significant efforts expended and costs incurred by Old Mutual to design its indexed annuity contracts with guarantees comparable to those under traditional fixed annuity contracts and implement a program aimed at marketing the contracts as insurance, if Rule 151A were adopted as proposed and made effective today, the Rule would require those same contracts to be registered as securities with the SEC. We believe that result is wholly inconsistent with established precedent and regulatory practice and recommends a close review of proposed Rule 151A and the reasoning supporting the Rule's proposal. In that regard, as you and your staff members review proposed Rule 151A and the SEC release proposing Rule 151A (the "Proposing Release"),[1] you may want to keep in mind the observations set forth below.

- The Supreme Court precedent the SEC cites in the Proposing Release as defining the scope of the Section 3(a)(8) exclusion, SEC v. Variable Annuity Life Ins. Co. ("VALIC")[2] and SEC v. United Benefit Life Ins. Co. ("United Benefit"),[3] address the status of a fundamentally different type of contract, a variable annuity contract under which a contract owner's interest was based substantially, if not wholly, upon his or her pro rata share in a segregated pool of assets and the performance of those assets. As we noted above, under an indexed annuity contract, a contract

[1] Indexed Annuities and Certain Other Insurance Contracts, Securities Act Release No. 8933 (June 25, 2008).

[2] SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959).

[3] SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967).

owner has no such interest and does not receive a pass through of the investment performance of a segregated pool of assets. In addition, unlike the contracts in VALIC and United Benefit, indexed annuity contracts must provide state nonforfeiture guarantees which in and of themselves are significant. Those guarantees were completely absent in VALIC, and substantially greater than those in United Benefit.[4] As such, the SEC's references to VALIC and United Benefit in the Proposing Release need to be viewed with some skepticism given the type of contract at issue in each case.

- Proposed Rule 151A would define certain indexed annuity contracts as not being eligible for the Section 3(a)(8) exclusion from regulation "... if the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract."[5] Unfortunately, neither Congress, the courts nor the SEC itself have ever previously applied such a test to determine the security status of an insurance contract. The test is simply unprecedented and there is no information in the Proposing Release on the source of the test.

- Proposed Rule 151A focuses its analysis primarily on the upside investment risk assumed by a contract owner for excess indexed interest, which the SEC characterizes as "the unknown, unspecified, and fluctuating securities-linked portion of the return."[6] While this focus is similar to the focus the SEC placed on discretionary excess interest in guaranteed interest contracts and other excess interest contracts in the late 1970s and mid-1980s, the SEC never articulated that focus as the sole determinant but only as one fact and circumstance to consider. There is no attempt to analyze the investment risk assumed by the insurer under an indexed annuity contract. If the purchaser of an annuity is more likely than not to receive more than the guaranteed amount under the contract because excess interest is calculated by reference to the performance of underlying securities, or an index, then the SEC concludes that such contracts "may to some degree be insured, but that degree may be too small to make the [] annuity a contract of insurance."[7] No distinction is made regarding whether such excess interest is guaranteed or is more than offset by the risks assumed by the insurer.

The approach taken by the SEC is inconsistent with the framework set forth by the Supreme Court in both VALIC and United Benefit for analyzing whether an insurance contract is a security. In VALIC, the majority opinion made clear that the assumption of investment risk by an insurance company was a critical factor

---

[4] United Benefit involved a variable annuity contract which guaranteed only 50% of premiums in the first year grading up to 100% after 10 years.

[5] Proposing Release at 5.

[6] Proposing Release at 25. In the Proposing Release, the SEC explains that by purchasing an indexed annuity, the purchaser "assumes the risk of an uncertain and fluctuating financial instrument," and that since the value of such an annuity "reflects the benefits and risks inherent in the securities market .... [then] the purchaser obtains an instrument that, by its very terms, depends on market volatility and risk." Proposing Release at 25-26.

[7] Proposing Release at 26.

in the determination of whether an insurance contract is a security. In relevant part the majority opinion stated "But we conclude that the concept of 'insurance' involves some investment risk-taking on the part of the company. . . . We deal with a more conventional concept of risk-bearing when we speak of 'insurance.' For in common understanding 'insurance' involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts."[8]

- In the Proposing Release, the SEC draws an unsettling analogy between indexed annuity contracts and securities such as mutual funds and variable annuities, stating that indexed annuities implicate the regulatory and protective purposes of the federal securities laws because they "are similar in many ways to mutual funds and variable annuities" and "are attractive to purchasers precisely because they offer participation in the securities market."[9] The SEC incorrectly equates the purchase of an indexed annuity contract with an investment in a market index, whereas a purchaser of an indexed annuity contract bears only a fraction of the risk of such an investment in a market index due to the guarantee of at least a substantial portion of principal and minimum interest as required by applicable state nonforfeiture law and the guarantee of previously credited interest.

* * *

We hope you and members of your staff find this letter and the other materials we have forwarded to your attention helpful. Should you have any questions relating to this letter, please do not hesitate to contact me at (410) 895-0082.

Sincerely,

Eric Marhoun (bjm)

Eric Marhoun
Senior Vice President & General Counsel

cc: Tom McDonald
Baker & Hostetler LLP

Thomas Bisset
Sutherland, Asbill & Brennan LLP

---

[8] VALIC at 622. Similarly, in United Benefit, the Supreme Court found that the limited guarantee of a return of premium under a "Flexible Fund" annuity contract to be an insufficient assumption of investment risk on the part of the insurer. In relevant part, the Court stated "And 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." United Benefit at 211.

[9] Proposing Release at 27.

Memorandum Regarding Exempt Status of Fidelity & Guaranty Life Insurance Company Indexed Rate Fixed Annuity Contracts – Page 2, Request #5

This memorandum sets forth a summary analysis of the status under Section 3(a)(8) of the Securities Act of 1933 (the "Securities Act") of the Fidelity & Guaranty Life Insurance Company (the "Company") indexed annuity contracts provided to the Securities and Exchange Commission (the "Commission" or "SEC") in response to the letter dated July 20, 2005 from Susan Nash, Associate Director of the Commission's Division of Investment Management (collectively, the "Contracts"). Each Contract is a fixed annuity contract that provides traditional annuity guarantees of principal and interest through a fixed interest crediting option, and various interest crediting options that credit indexed interest based on formulas that take into account movements in either the S&P 500 Index or the Dow Jones Industrial Average ("DJIA"). Financial products such as the Contracts are commonly referred to as equity-indexed annuities ("EIAs").

The Company believes that the Contracts are insurance contracts and that the Company is eligible to rely on the Section 3(a)(8) exclusion from registration and regulation under the Securities Act and other federal securities laws. Based on relevant judicial precedent and available Commission guidance on the scope of the Section 3(a)(8) exclusion, it is the Company's understanding that whether EIAs, such as the Contracts, are insurance products eligible to rely on the Section 3(a)(8) exclusion generally depends on the guarantees set forth in the EIA contract and the manner in which the sponsoring insurer markets the contract.

The Company assumes substantial investment risks under each Contract through guarantees of Contract owner principal (less surrender or other charges) and the contractually mandated methods for crediting declared and indexed rates of interest. As discussed in more detail below, the Company assumes investment risks under the Contracts substantially the same as those assumed under other fixed annuity contracts. Moreover, the Contracts substantially comply with the investment risk criteria set forth in the Commission's safe harbor rule under Section 3(a)(8) – Rule 151.[1] The Company also assumes meaningful mortality risk through long-term guarantees of annuity purchase rates and the payment of a death benefit (without the imposition of a surrender charge).

Similarly, consistent with both judicial and Commission interpretations that set forth standards for the marketing of insurance products eligible to rely on the Section 3(a)(8) exclusion, the marketing program for the Contracts emphasizes a fair and balanced approach to the presentation of both the insurance and investment aspects of the Contracts.

---

[1] 17 CFR 230.151

I. Seminal Judicial Precedent Supports the Availability of the Section 3(a)(8) Exemption

A. The investment risks assumed by the Company are significantly greater than the investment risks assumed in the only U.S. Supreme Court decisions interpreting Section 3(a)(8).

There have been only two U.S. Supreme Court decisions interpreting the scope of Section 3(a)(8) -- S.E.C. v. Variable Annuity Life Insurance Co. of America ("VALIC")[2] and S.E.C. v. United Benefit Life Insurance Co. ("United Benefit").[3] Both the decisions concerning the particular annuity contracts at issue in those cases, as well as the Court's analytical methodology used to interpret Section 3(a)(8), support a conclusion that the Contracts should be entitled to rely upon the Section 3(a)(8) exclusion.

In VALIC, the Supreme Court held that the annuity contract at issue, a variable annuity, was not an "annuity" within the meaning of Section 3(a)(8) because the entire investment risk was borne by the annuitant, not the insurance company. Premiums collected under the VALIC contract were invested in common stocks and other equities, while benefits payable under the VALIC contract varied with the success of the investment portfolio in equities -- an interest which the Court characterized as having "a ceiling but no floor."[4]

The Court noted that the concept of "insurance" typically involves the 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 all investment risks on the annuitant, not the insurance company, failing the test of "insurance."[5] The Court observed that the VALIC contract guaranteed the annuitant only "a pro rata share of what the portfolio of equity interests reflects -- which may be a lot, a little, or nothing . . . . There is no true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding, and usage."[6]

In an attempt to provide the investment risk assumption that the Supreme Court found lacking in VALIC, the insurance company in United Benefit guaranteed that the value of a deferred (essentially variable) annuity contract after ten years would never be less than the aggregate net premiums paid under the contract. The United Benefit contract guaranteed that the first year cash value of the annuity would never be less than 50% of net premiums paid and that, after ten years, the value would be no less than 100% of aggregate net premiums paid under the contract. In discussing this product design, the Court noted that United Benefit merely promised to return, at a minimum, net premiums paid, an "amount [that] is substantially less than that guaranteed by the same premiums in

---

2 359 U.S. 65 (1959).

3 387 U.S. 202 (1967).

4 VALIC, 359 U.S. at 74.

5 Id. at 71.

6 Id. at 71-73 (footnote omitted).

a conventional deferred annuity contract." The Court found that while this guarantee "reduce[d] substantially the [contract holder's] investment risk," "the assumption of an investment risk cannot by itself create an insurance provision."[7]

The Company, unlike the insurance companies that issued the contracts in VALIC and United Benefit, is required to provide state nonforfeiture guarantees under the Contracts which in and of themselves are significant. These guarantees were completely absent in VALIC, and are substantially greater than those provided in United Benefit. In that regard, the Contracts typically guarantee that either 100% or 87.5% of premiums will accumulate at interest rates of between 1% and 3%.[8] The Company believes that these guarantees more than satisfy the general investment risk standards as articulated by the U.S. Supreme Court in VALIC and United Benefit.

B. The eligibility of the Contracts for the Section 3(a)(8) exclusion is supported by the only judicial precedent to consider the securities status of an EIA contract.

In Malone v. Addison Ins. Mktg., Inc. ("Malone"), the U.S. District Court for the Western District of Kentucky held that an equity-indexed annuity was entitled to the Section 3(a)(8) exclusion from the definition of a security under the Securities Act, and that the annuity was within the Rule 151 safe harbor.[9]

The court framed its inquiry as a proportionality test that required it to determine whether the contract "operates more like a variable or a fixed annuity." The court reviewed caselaw and Rule 151 and focused on the division of the investment risk between the insurer and the insured. The court found that the insurer had assumed sufficient investment risk because it was obligated to return premium plus 3% annual interest, less any applicable surrender charge, regardless of how poorly the market performed. The only investment uncertainty assumed by the investor, according to the court, was whether she would receive interest beyond 3 percent per year on her premium payment. Further, the court noted that there was no direct correlation between the benefit payments and the performance of the investments made with the contract owner's money. The court concluded the proportionality test had been met "[b]ecause the Defendants assume a much greater risk, Plaintiff's investment seems a lot like insurance and less like an investment."[10]

Here, the Contracts subject the Company to substantial investment risk through guarantees that must at least equal and may exceed state nonforfeiture guarantees.

---

7 Id. at 211 (emphasis added).

8 The Loyalty Rewards Contract guarantees 80% of the initial premium and 88% of all subsequent premiums at an annual effective interest rate of 3%. The guarantee reflects compliance with state nonforfeiture law standards that have been revised in most states following initial issuance of the Contract, and as such, sales of the Loyalty Rewards Contract have been discontinued in most states. Effective September 1, 2005, the Company will no longer offer the Loyalty Rewards Contract.

9 2002 U.S. Dist. LEXIS 18885 (WD Ky 2002).

10 Id. at 9 citing VALIC at 71.

Further, the Company assumes a meaningful mortality risk through the guarantee of a death benefit (including the waiver of any otherwise applicable surrender charges) and through the availability of annuity payment options with fixed purchase rates. The Company's investment risks and mortality risks under the Contracts are significant; they are greater than the risks borne by Contract owners. Thus, using the proportionality test, the investment risks and mortality risks assumed by the Company are sufficient under the conventional investment risk and mortality risk tests used to qualify for exemption under Section 3(a)(8) of the Act.

II. The Contracts Involve Significant Assumption of Investment Risks by the Company

A. Consistent with judicial precedent and the Rule 151 investment risk test, the Contracts do not effect a pass through of any investment performance.

The Contracts provide for values and benefits that are independent of the investment experience of the Company's general account. The interest crediting provisions tie the crediting of interest to minimum values at stated rates of interest and to changes in value of external indices. In this regard, the Contracts both are distinguishable from the VALIC and United Benefit contracts where values varied with the values of identified pools of assets, and satisfy the investment risk condition in Rule 151 that contract value not vary according to the investment experience of a separate account.

The value of the Contracts does not vary according to the investment experience of a separate account and the assets supporting the Contracts are held as a part of the general account assets of the Company. Those assets do not support the Contracts to any greater or lesser extent than they support any other general account liability of the Company. Moreover, the general account assets of the Company are subject to all of the various quantitative and qualitative restrictions on insurance company general account investments under state insurance law.

The Contracts comply with the first investment risk condition under Rule 151, the "safe harbor" rule for qualifying annuity contracts under Section 3(a)(8).[11] That investment risk condition of Rule 151 requires that for the sponsoring insurer to be deemed to have assumed investment risk under a contract, the contract can not vary with the investment experience of a separate account and that all of the insurer's general account assets meet the guarantees provided under the contract.

B. Each Contract guarantees the preservation of principal and previously credited interest in compliance with Rule 151.

Under any in-force Contract, upon full surrender of the Contract, the Contract owner would be entitled to receive an amount equal to the greater of:

---

11 Definition of Annuity Contract or Optional Annuity Contract, Securities Act Release No. 6645 (May 29, 1986) (adopting Rule 151) (hereinafter referred to as "Release 6645").

- the "Minimum Guaranteed Surrender Value" ("MGSV") for the Contract; or
- the contract value - that is, the sum of purchase payments received and any applicable premium bonus, *minus* withdrawals (including any applicable surrender charges), *plus* any indexed interest credited - *minus* any applicable surrender charges.

Under the Spectrum Series Index Annuity contracts, except for the Spectrum Choice Bonus contract, and the Index Rewards Choice 5 contract, the MGSV represents a guarantee of principal (100% of premium) and a positive interest credit each year (ranging from 1% - 3%), less any surrender charge. Because there can be no crediting of negative interest under a Contract, the MGSV feature essentially ensures a guarantee of principal and previously credited interest.

Under the Loyalty Series Index Annuity contracts and the Spectrum Choice Bonus Contract, the MGSV is based on a premium amount of something less than 100% of premium (typically 87.5% of premium). Nevertheless, this meets the criterion of a guarantee of "principal" plus previously credited interest under Rule 151 and therefore would also be sufficient under Section 3(a)(8). Rule 151's actual requirement is to guarantee "the principal amount of purchase payments and interest credited thereto, *less any deduction (without regard to timing) for sales, administrative or other expenses or charges*" (emphasis added). Clearly, Rule 151 and Section 3(a)(8) do not require a guarantee of 100% of premiums. Charges and expenses can be deducted, even if that results in the contract owner receiving less on a full surrender than the amount he or she invested. Here, the "haircut" is the economic equivalent of a front-end sales or administrative charge of that amount. It is a fixed percentage, established at issue, and it is not affected by any market movements or investment performance.

Wholly independent of the MGSV guarantees are other contractual provisions that provide a guarantee of principal and previously credited interest in the context of contract values. Specifically, the index interest crediting options provide that an index credit will never be less than zero -- there will be no negative interest. Putting aside the deduction of surrender charges (discussed below) even under a Contract with an MGSV based on a percentage of premium at less than 100%, there is a guarantee of principal plus previously credited interest, because the Contract owner is guaranteed the greater of the MGSV or contract value - principal at 0.0% (which effectively guarantees principal), and an annual index credit that will never be less than $0.00 (which effectively guarantees previously credited interest).

With respect to the surrender charges assessed under the Contracts, both judicial precedent and Rule 151 clearly permit the deduction of traditional surrender or withdrawal charges that assess a fixed rate established at the time of contract issuance and do not vary with an insurer's investment performance or changes in market interest rates. Because a typical surrender or withdrawal charge does not shift additional investment risk to the Contract owner, it is a permissible charge under Rule 151.

The surrender charges under the Contracts are fixed percentages that are set at the time a Contract is issued and are contingent solely on when a surrender occurs during the surrender charge period, such charges are unrelated to the Company's investment experience, unrelated to market rates at the time of surrender, and unrelated to changes in the S&P 500 Index or the DJIA. Thus, the surrender charges under the Contracts do not shift investment risk to the Contract owner.

Importantly, the Contracts do not provide for a market value adjustment ("MVA") on surrenders or withdrawals that could invade principal or any previously credited interest.[12] By not imposing a MVA under the Contracts, even a limited MVA that could invade only some portion of previously credited interest, the Company assumes a significant risk of adverse movements of market rates of interest and the prospect of high levels of disintermediation from the Contracts.

C. The Company guarantees minimum rates of interest under the Contracts that substantially comply with Rule 151 and that place substantial investment risk on the Company.

The third investment risk condition of Rule 151 requires that for the life of the contract an annuity contract credit *net* premiums and interest previously credited thereto with interest at a rate at least equal to the minimum specified interest rate required by the relevant nonforfeiture law. Rule 151 defines the term "specified rate of interest" as:

> a rate of interest under the contract that is 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. If that jurisdiction does not have an applicable nonforfeiture law at the time the contract is issued (or if the minimum rate applicable to an existing contract is no longer mandated in that jurisdiction), the specified rate under the contract must at least be equal to the minimum rate then required for individual annuity contracts by the NAIC Standard Nonforfeiture Law.

While the Contracts do not guarantee that any specified amount of indexed interest will be credited under the Contracts (other than it will never credit negative interest), the Company will provide at least the MGSV on full surrender of a Contract, and the MGSV will reflect a permanent guaranteed interest rate (from 1% to 3%) and will always equal or exceed the minimum nonforfeiture amount required under state nonforfeiture law.

---

12 The Commission in Release 6645 noted that a contract with an MVA feature does not qualify for the Rule 151 safe harbor because it allows the insurer to adjust the amount of proceeds a contract owner receives upon an early surrender to reflect changes in the market value of its portfolio securities supporting the contract. *See* Release 6645 at ¶ 88,132 nn. 16-17.

As noted above, the surrender value a Contract owner will receive on full surrender of a Contract is the greater of the (i) MGSV and (ii) contract value *minus* any applicable surrender charges. For each Contract, the indexed crediting option(s) will each have a permanent effective annual interest rate in the MGSV calculation at least equal to the effective annual interest rate required by the state nonforfeiture law.

The permanent minimum interest rates under the Contracts contrast favorably with the concern raised by the Commission in the adopting release for Rule 151, Release 6645, that giving insurers the ability to modify the minimum interest rate guaranteed on group annuity contracts at five-year intervals would not be consistent with there being some element of risk-taking by the insurer in guaranteeing that at least some portion of the benefits will be paid in a fixed amount.[13] The Contracts also contrast favorably with those issued by Penn Mutual Life Insurance Company ("Penn Mutual") and evaluated in the Peoria Union Stock Yards Co. v. Penn Mutual Life Insurance Company.[14] In that case, 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 Penn Mutual failed to provide *any* guarantee of interest under the annuity contract after the third contract year.[15] Under the Contracts, by contrast, the effective annual interest rate in the MGSV calculation will at least equal the effective annual interest rate required by the applicable state nonforfeiture law.

For all the above reasons, the Company believes the specified rates of interest credited under the Contracts place an investment risk on the Company that is comparable to the risk inherent in the third investment risk condition of the Rule 151 safe harbor under Section 3(a)(8).

D. The Company assumes substantial investment risk under the Contracts through long-term guarantees of credited index interest that are comparable to the one-year interest rate requirement under Rule 151.

In proposing Rule 151, the Commission recognized that the longer the period for which interest is guaranteed, the greater the degree of investment risk assumed by the insurer because the insurer assumes the risk that it will not earn a sufficient amount from its general account assets to pay the current rate guaranteed for that period.[16] The Commission designated a one-year period as necessary to rely on the safe harbor of the Rule, recognizing that one year was an arbitrarily set period and that contracts that do not meet this test still may qualify for the Section 3(a)(8) exclusion.[17]

---

13 Release 6645 at ¶ 88,132-33.

14 698 F.2d 320 (7th Cir. 1983).

15 Id at 324-25.

16 *See* Definition of Annuity Contract or Option Annuity Contract, Securities Act Release No. 6558, ¶ 87,158, (Nov. 21, 1984) (proposing Rule 151) (hereinafter referred to as "Release 6558").

17 Id.

Under the indexed interest crediting options available under the Contracts, interest (if any) is calculated and credited at the end of each one, two or three-year index crediting period; a new interest crediting period begins upon the expiration of the prior index crediting period. Index credits are not calculated or credited between Contract anniversaries. Once the indexed interest is determined and credited, it is not recalculated and is fully "vested." The Contracts also specify the formula used in determining indexed interest, as well as the other terms of each Contract's indexing features, and the Company has no discretion whatsoever in determining the amount of indexed interest credited at the end of each index crediting period. The index (unless discontinued), the formula for determining the indexed interest rate credited at the end of each index crediting period, the date on which the indexed interest is calculated and credited, the participation rate, and the duration of the term are all determined at the time the Contract is issued and do not change. The Company has discretion only to change the cap rate (subject to a guaranteed minimum) that determines the maximum index rate at the beginning of each index crediting period, and then the cap rate is guaranteed for the index crediting period which in all cases would be at least one year in duration, consistent with the minimum one-year concept set forth in Rule 151. The Contracts also clearly specify which external index will be used as a benchmark for determining indexed interest.

Moreover, the Company guarantees that it will not credit negative interest to the Contracts. The Company thus bears the significant investment risk that the return on its own invested assets will be less than the rate determined under the independent indexing features. Thus, the Company bears the investment risk of paying out the indexed interest - calculated pursuant to a formula fixed in advance in the 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. That risk is substantial given that the Contracts provide for 100% participation in the relevant Index and that participation rate does not change for the life of the Contract. In addition, because the Company does not impose an MVA under the Contracts, the Company can not mitigate its investment risk in an adverse interest rate environment.

The Commission permits insurers to make use of index features under Rule 151 when determining excess interest rates, recognizing that an insurer using an index feature bears a meaningful investment risk in that the return on its own invested assets may not equal the rate determined under the index feature.[18] Rule 151 permits the use of index features to determine interest rates that will be guaranteed under the contract for the 12-month period.[19] Under the Contracts, as noted above, the external index and all of the factors that bear on the amount of indexed interest actually credited are specified and guaranteed in advance for periods of at least one year. Therefore, because the Company promises to pay minimum guarantees and an indexed interest rate that is measured by the performance of an external index, and so does not pass through the performance of its own investments, the Company bears investment risk comparable to that required under the Rule 151 safe harbor and sufficient to qualify the Contracts for the Section 3(a)(8) exemption.

---

[18] *See* Release 6558 at 88,136.

[19] Release 6645 at 88,136 (emphasis added).

III. The Company assumes a meaningful mortality risk under the Contracts through long-term guarantees of the payment of a death benefit and the payment of annuity benefits at purchase rates fixed at the time of Contract issuance.

The Company assumes a meaningful mortality risk under the Contracts in the form of the death benefit and annuity payment options. Like other conventional annuity products, the Contracts are designed so that while a Contract is in force and before the annuitization period begins, the Contract provides for the payment of a death benefit. If the annuitant dies before the annuitization date, the death benefit payable is equal to the greater of the MGSV or Contract Value determined as of the valuation date coincident with, or next following the date the Company receives proper proof of the annuitant's death, an election specifying the distribution method, and any required state forms. The death benefit is significant in that interest will be credited to an indexed strategy up until the death benefit is calculated. This contrasts to the general Contract surrender provisions under which no indexed interest will be credited to amounts surrendered during an index period. Upon payment of the death benefit, the Company will also waive any applicable surrender charge. Waiving the surrender charge is significant, as the surrender charge is one of the primary mechanisms by which the Company can expect to recoup its administrative and marketing costs in the event of a premature surrender during an index crediting period.

In addition to the assumption of mortality risk associated with the payment of the death benefit under the Contracts, the Company assumes significant mortality risk in connection with the annuity payment options offered under the Contracts. Several of the annuity payment options available under the Contracts provide for annuity payments based upon life contingencies. By currently providing under the Contracts guaranteed life annuity options that can be selected at some future time, the Company assumes a mortality risk that the longevity of its annuitants may be greater than that assumed in setting the guaranteed annuity rates.

Both judicial and Commission interpretations recognize that mortality risk is an important consideration when determining whether annuity contracts come with the Section 3(a)(8) exclusion.[20] Here, the Company's assumption of a meaningful mortality

---

[20] *E.g.*, Id.; Grainger v. State Security Life Insurance Co., 547 F.2d 303, 307 (5th Cir. 1977) (considering the relationship between the size of the death benefit and the size of premium payments as part of the court's Section 3(a)(8) analysis), reh'g denied, 563 F.2d 215 (5th Cir. 1977), cert. denied sub nom. Nimmo v. Grainger, 436 U.S. 932 (1978); Dryden v. Sun Life Assurance Co. of Canada, 737 F. Supp. 1058 (S.D. Ind. 1989) (concluding that the insurer's obligation to pay a fixed sum to a designated beneficiary upon the death of the owner of a life insurance policy caused the insurer to bear the risk of poor performance of its investments).

In a general statement of policy issued on April 5, 1979, the Commission identified the assumption of mortality risks and investment risks as central features of life insurance or annuity contracts. Statement of Policy Regarding the Determination of the Status Under the Federal Securities Laws of Certain Contracts Issued by Insurance Companies, Securities Act Release No. 6051, Fed. Sec. L. Rep. (CCH) ¶ 2583-8, at 2583-9 (Apr. 5, 1979). In the release adopting Rule 151, however, the Commission risk weighs heavily in favor of finding the Contracts fall within the Section 3(a)(8) exclusion.

IV. Marketing

The Company has in place procedures and controls to ensure that its marketing of the Contracts comports with legal standards governing the sale of fixed insurance contracts. Among other things, those procedures and controls include the requirement that promotional materials related to the Contracts be reviewed and approved by a team comprised of representatives from the Company's various business units prior to use. They also include procedures and controls for the coding and identification of each piece of sales literature or other promotional material, re-approval of such materials on an annual basis and discontinuance where warranted by regulatory or other concerns.

A. The Company markets the Contracts as fixed insurance contracts.

The Company has undertaken significant efforts to ensure that its marketing program for the Contracts markets the contracts as fixed insurance contracts consistent with the marketing standards articulated by courts and the Commission in the context of the Section 3(a)(8) exclusion. In that regard, the Company has sought to ensure that sales literature for the Contracts and written presentations by agents and other promotional efforts provide a fair and balanced presentation of both the insurance and investment aspects of the Contracts, and where appropriate, emphasize each Contract's usefulness as a long-term insurance product for retirement or income security purposes. The Company has also sought to ensure that the Contracts are not promoted with any undue emphasis placed on the investment aspects of the Contracts.

Two steps the Company has taken to ensure that the marketing program for the Contracts meets the above standards have been the development of fairly comprehensive marketing guidelines governing the content and presentation of sales literature and the development of an agent training manual. The marketing guidelines identify both what should be and what should not be included in sales literature for the Contracts. The Company, under the team approach described above, closely reviews all marketing materials to ensure compliance with the marketing guidelines, including, the complete and accurate description of Contract features.

The marketing guidelines require, among other things, that each piece of sales literature for the Contracts emphasize the long-term nature of the Contracts and the insurance benefits of the Contracts, such as the death benefit and annuity payout options. The guidelines emphasize that the Contracts are fixed annuity contracts and are designed as appropriate planning vehicles for retirement security. Conversely, the guidelines caution against describing the Contracts' indexing features as a means for participation in

---

withdrew Release 6051 and abandoned this requirement for purposes of the safe harbor. Nevertheless, the Commission continued to express the view that mortality risk may be an appropriate factor to consider in determining the availability of an exemption from Section 3(a)(8). *See, e.g.,* Brief for the United States as Amicus Curiae at 9, Variable Annuity Life Insurance Co. v. Otto, No. 87-600 (1988).

a stock market index or the equity markets in general and comparing the Contracts with mutual funds or other investment vehicles.

The agent's training manual incorporates the guidelines and also sets forth other standards and procedures for agents to follow in dealing with customers. They include procedures for the use of only Company approved sales materials with customers and the completion and forwarding of an application and suitability form to the Company for review for each prospective purchaser. The Company has also voluntarily adopted suitability guidelines and increased its supervision of its agent sales force with respect to sales of the Contracts.

The Company believes that the marketing guidelines, the agent's training manual and its supervision of the marketing program for the Contracts have been effective and that the marketing program meets the standards for marketing fixed insurance products articulated by the courts and the Commission.

B. The marketing of the Contracts is consistent with judicial precedent.

The Company's decision to market the Contracts as fixed insurance contracts, and not primarily as investments, 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 from registration 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."[21] 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."[22]

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 Contracts. The federal district court in Associates in Adolescent Psychiatry v. Home Life Insurance Company 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.[23] 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 . . . .

---

21 United Benefit, 387 U.S. 202.

22 Id.

23 941 F.2d 561 (7th Cir. 1991), cert. denied, 502 U.S. 1099 (1992).

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."[24]

This finding of the Home Life court was reiterated in the decision of the federal district court in Berent v. Kemper Corp.[25] 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."[26]

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]aking 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 Contract 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.[27]

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

---

24 Id. (emphasis added).

25 780 F. Supp. 431 (E.D. Mich. 1991); aff'd, 973 F. 2d 1291 (6th Cir. 1992).

26 Id. at 443.

27 225 F. Supp. 2d. at 753-754.

Section 3(a)(8). However, it has agreed with judicial determinations that references to investment features of a contract do not necessarily 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 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."[28]

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

Conclusion

Because the Company assumes substantial investment risks and meaningful mortality risks under the Contracts and because the Contracts are marketed primarily as insurance, the Contracts qualify as annuity contracts eligible for exclusion from the federal securities laws under Section 3(a)(8) of the Securities Act.

---

[28] Release 6645 at 88137.

OLD MUTUAL
INVEST INSURE INNOVATE

Old Mutual Financial Network

July 31, 2008

The Honorable Ralph Tyler
Commissioner
Maryland Insurance Administration
525 St. Paul Place
Baltimore, MD 21202-2272

Dear Commissioner Tyler:

I wanted to quickly thank you for taking the time to meet with me and Tom McDonald to discuss SEC Proposed Rule 151A – particularly on such short notice. It was nice seeing you and meeting Casey Mashburn.

I was quite heartened by our discussion and your understanding of our concerns about this ill-conceived proposal by the SEC. We think the SEC proposal will only serve to muddy the waters on regulation of fixed indexed products and interfere with the good work being done by the NAIC and states like Maryland seeking to address marketplace issues in a constructive and thoughtful manner.

In any event, we will keep you posted of industry efforts. And I am hopeful you will join with Commissioner Voss and other NAIC representatives in dissuading the SEC from hastily adopting this proposal without a more careful analysis of the proposal's potential repercussions including its impact on state regulation of insurance and annuities.

I will look forward to seeing you at the next NAIC conference if not sooner. Thank you again to you and your staff for your time and leadership on these important issues.

Sincerely yours,

Eric Marhoun
Senior Vice President & General Counsel

cc: Marion "Casey" Mashburn, Supervisor, Life Actuarial Review Unit
Tom McDonald, Esq.

Life and Health Insurance
Industry Brief

Steven D. Schwartz, CFA
(312) 612-7686
Steven.Schwartz@RaymondJames.com

Jason Royer
Senior Research Associate
(312) 612-7688

EQUITY RESEARCH

June 26, 2008

SEC Staff Proposal: Index Annuities Should be Considered Securities

In what we view as an almost unbelievable development, yesterday, the SEC staff officially recommended to the Board of Governors that a new rule [so-called Safe Harbor Rule 151(A)] be adopted, which would basically deem any index annuity to be a security and require registration of both the product and the sellers of the product.

The SEC staff recommended a ruling, consisting of two "prongs." If an annuity passes both prongs, it should be considered an investment, rather than an insurance, product:

1) If amounts payable by the insurance company are calculated, in whole or in part by reference to the performance of a security, including a group or index of securities.
2) Amounts payable by the insurance company, under the contract, are more likely than not to exceed the amounts guaranteed under the contract.

Index annuities, which base returns over and above guaranteed amounts on performance of an index and provide expected returns above those of minimum guaranteed amounts, clearly pass both prongs. We believe traditional fixed annuities with market value adjustment mechanisms may also pass both prongs. As traditional fixed annuities and other traditional fixed insurance products provide for amounts payable that are more likely than not to exceed the amounts guaranteed under the contract, we believe prong 1 is of most importance.

(As an aside, we even wonder if traditional fixed annuities without market value adjustments pass both prongs. Are not returns calculated in whole by reference to the general account – which is in fact a group of securities?)

Proposal Appears to Ignore Case Law

Concentrating solely on the index annuity question, we believe the proposal ignores existing case law surrounding the Securities Act of 1933, which exempts from registration products sold by insurance companies.

In *S.E.C. v. VALIC* (1959), Justice William Douglas (writing for the majority) states that variable annuities are investments because, "the holder of a variable annuity cannot look forward to a fixed monthly or yearly amount in his advancing years." Mr. Douglas also writes "the difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a pro rata share of what the portfolio of equity interest reflects – which may be a lot, a little, or nothing." Additionally, Douglas stated that, "...in common understanding 'insurance' involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts."

Please read disclosure/risk information on page 4 and Analyst Certification on page 5.

We believe index annuities meet all of Justice Douglas' criteria. First, investment risk is placed firmly on the issuer: if options backing the index annuity index value underperform, the insurer would have to dip into its own earnings to make up the difference. Additionally, if the insurer's general account assets underperform, it bears that risk.

Second, the index annuity policyholder can look forward to a fixed monthly or annual amount upon maturity (in fact well before maturity). The policyholder may get more, but is guaranteed a fixed amount.

And finally, there is a guarantee that some fraction of the benefits will be payable in fixed amounts.

In *SEC v. United Benefit Life* (1967), the court asked two key questions with regard to the accumulation phase of an annuity: 1) is a fixed amount of benefits stipulated and 2) is there "some shifting of risk from policyholder to insurer, but no pooling of risks among policyholders." Additionally, does the insurer have a "dollar target to meet." If the answer is yes to both, the product should be considered insurance.

Index annuities would again seem to meet the *United Benefit* tests. Index annuities stipulate a fixed amount of benefits (although the amount could be higher), significant risk is shifted to the insurer (there is no pooling of risks among policyholders), and the index annuity provider most definitely has a "dollar target to meet."

In *Malone v. Addison Insurance Marketing* (2002), the Western District Court of Kentucky found that the fact that a plaintiff's argument that her return from an index annuity over and above the minimum guarantee was variable, and thus did involve an element of risk and uncertainty, was inconclusive as the insurer was found to bear substantially more risk than the purchaser.

Finally, the original Safe Harbor Rule 151 (1986) clearly included index annuities in the exemption. The rule read:

> Any annuity contract or optional annuity contract (a contract) shall be deemed to be within the [exemption] provisions of section 3(a)(8) of the Securities Act of 1933, provided,
>
> (1) The annuity or optional annuity contract is issued by a corporation (the insurer) subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia;
> (2) The insurer assumes the investment risk under the contract as prescribed in paragraph (b) of this section; and
> (3) The Contract is not marketed primarily as an investment;

Criterion 2 is satisfied if:

(1) the value of the contract does not vary according to the investment experience of a separate account;
(2) The insurer for the life of the contract
    (i) Guarantees the principal amount of the purchase payments and interest credited thereto, less any deduction (without regard to timing) for sales, administrative or other expenses or charges; and
    (ii) Credits a specified rate of interest to... net purchase payments and interest credited thereto; and
(3) The insurer guarantees that the rate of any interest to credited in excess of that described in paragraph (b)(2)(ii) of this section will not be modified more frequently than once per year.

We believed, if anything, that the SEC staff would concentrate on Criterion 3, not basically amend Criterion (2), Sub-criterion (3) by adding that the sub-criterion is not effective if the excess interest credited is based on an index's performance.

But that is exactly what the SEC did, adding another hoop to crawl through on top of the question of which party to the contract bears a substantial amount of the risk.

Where Does the SEC Go from Here?
Following yesterday's proposal, the Commission will publish the proposed new rule. This may have already occurred by the time this note has been released, but will likely occur in no less than a few days.

A public comment period will follow, likely lasting 60 to 90 days.

At that time, the SEC staff will make its final recommendation to the Board of Governors. The staff may alter its proposal slightly, change its mind altogether and suggest that the Board of Governors refuse to make the official proposal into a rule, or recommend that the Board of Governors accept the proposal as originally proposed. Any substantial change to the proposal would necessitate a new Open Meeting.

The Board of Governors can accept the proposal and make it a rule, decline the proposal, or ignore the issue completely.

If the rule is accepted, Safe Harbor Rule 151 (A) will go into effect 12 months from the time it is published in the Federal Register.

Where Does the Life Industry Go from Here?

Undoubtedly, industry groups and index annuity companies will launch a barrage of opposing comments (in fact, one SEC Governor stated publicly that he expected as much).

If this does not have the desired effect of either changing the staff's collective view or of persuading the Board of Governors to decline or ignore the staff's proposal, then we would expect a flurry of petitions to the Washington, D.C., Appellate Court for injunctive relief based on a lack of jurisdiction and violation of the Securities Act of 1933. This can occur once the rule appears in the Federal Register; the industry does not have to wait to file until the rule becomes effective.

Injunctive relief, if it is forthcoming, could take as long as a year. Eventually, we believe the matter would likely wend its way to the Supreme Court.

Meanwhile, we believe index annuity players will need to work with marketing organizations to ensure that the maximum number of agents become registered. This could be done through the life company's own broker/dealer unit or through an "index annuity friendly" broker/dealer. For those agents, who for one reason or another will not become registered, new products – likely some sort of fixed annuity with long-term care or enhanced benefits – will have to be developed.

The Net Effect?

The proposal is the worst case scenario that could have come out of the SEC Open Meeting. If the proposal is accepted by the Board of Governors as is and becomes official, there will likely be one-time costs associated with the staffing of broker/dealers and the effort involved in getting agents registered. Costs in the $5-10 million range would not seem unreasonable. While not the end of the world, no fun either. Ongoing costs will likely be considerably less.

The $64,000 dollar question is the effect on sales. Last night, we were able to speak with the management of two large producer organizations. Although hardly a statistically significant sample, each indicated that while agents with substantial index annuity sales would likely get registered, those making just a few sales a year would not – which would add up. These marketing organizations estimated that as much as 20% to 50% of their index annuity production could be effectively eliminated.

Summary

The SEC staff's decision to propose rules requiring the registration of index annuities based on an intrinsic part of the product design caught us, and we think most industry observers and participants, by surprise, as we expected the SEC to primarily concentrate on rules regarding how the product is marketed and/or limit the size and length of surrender charge periods.

We expect the industry defense to be spirited both during the public comment period and in the legal courts if the Board of Governors accepts the current proposal.

Ultimately, we expect the industry to prevail, as the SEC staff proposal appears to us to has no basis in the Securities Act of 1933 and its existing case law. This said, it is certain that the index annuity industry has entered into a period of substantial uncertainty.

Important Investor Disclosures

Strong Buy (SB1)................ Expected to appreciate and produce a total return of at least 15% and outperform the S&P 500 over the next six months. For higher yielding and more conservative equities, such as REITs and certain MLPs, a total return of at least 15% is expected to be realized over the next 12 months.

Outperform (MO2)............... Expected to appreciate and outperform the S&P 500 over the next 12 months. For higher yielding and more conservative equities, such as REITs and certain MLPs, an Outperform rating is used for securities where we are comfortable with the relative safety of the dividend and expect a total return modestly exceeding the dividend yield over the next 12 months.

Market Perform (MP3)......... Expected to perform generally in line with the S&P 500 over the next 12 months and is potentially a source of funds for more highly rated securities.

Underperform (MU4)........... Expected to underperform the S&P 500 or its sector over the next six to 12 months and should be sold.

Out of approximately 688 rated stocks in the Raymond James coverage universe, 58% have Strong Buy or Outperform ratings (Buy), 36% are rated Market Perform (Hold) and 6% are rated Underperform (Sell). Within those rating categories, 30% of the Strong Buy- or Outperform (Buy) rated companies either currently are or have been Raymond James Investment Banking clients within the past three years; 18% of the Market Perform (Hold) rated companies are or have been clients and 7% of the Underperform (Sell) rated companies are or have been clients.

Suitability ratings are not assigned to stocks rated Underperform (Sell). Projected 12-month price targets are assigned only to stocks rated Strong Buy or Outperform.

Suitability Categories (SR)

Total Return (TR)................ Lower risk equities possessing dividend yields above that of the S&P 500 and greater stability of principal.

Growth (G)............................ Low to average risk equities with sound financials, more consistent earnings growth, possibly a small dividend, and the potential for long-term price appreciation.

Aggressive Growth (AG)..... Medium or higher risk equities of companies in fast growing and competitive industries, with less predictable earnings and acceptable, but possibly more leveraged balance sheets.

High Risk (HR)...................... Companies with less predictable earnings (or losses), rapidly changing market dynamics, financial and competitive issues, higher price volatility (beta), and risk of principal.

Venture Risk (VR)................ Companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, and a substantial risk of principal.

Analyst Holdings and Compensation: Equity analysts and their staffs at Raymond James are compensated based on a salary and bonus system. Several factors enter into the bonus determination including quality and performance of research product, the analyst's success in rating stocks versus an industry index, and support effectiveness to trading and the retail and institutional sales forces. Other factors may include but are not limited to: overall ratings from internal (other than investment banking) or external parties and the general productivity and revenue generated in covered stocks.

Raymond James Relationships: RJA expects to receive or intends to seek compensation for investment banking services from the subject companies in the next three months.

General Risk Factors: Following are some general risk factors that pertain to the projected 12-month target prices included on our research for stocks rated Strong Buy or Outperform: (1) Industry fundamentals with respect to customer demand or product / service pricing could change and adversely impact expected revenues and earnings; (2) Issues relating to major competitors or market shares or new product expectations could change investor attitudes toward the sector or this stock; (3) Unforeseen developments with respect to the management, financial condition or accounting policies or practices could alter the prospective valuation; or (4) External factors that affect the U.S. economy, interest rates, the U.S. dollar or major segments of the economy could alter investor confidence and investment prospects.

Specific Investment Risks Related to the Industry or Issuer

Life and Health Insurance Industry Risks

Life and Health Insurers face many risks including but not limited to poor equity market performance (and the related effect on fees, guaranteed minimum death benefit reserves, and deferred acquisition cost amortization), interest spread compression, deteriorating credit quality, adverse mortality and morbidity experience, and continuing pressure from rating agencies. Providers of tax-deferred asset accumulation products face uncertainty in the face of passage of the dividend tax cut, which could lead to a decline in sales as insurance products would, to some extent, lose the advantage of tax-deferral over equity mutual funds and direct equity investment.

Additional Risk and Disclosure information, as well as more information on the Raymond James rating system and suitability categories, is available at www.rjcapitalmarkets.com/SearchForDisclosures_main.asp. **Copies of research or Raymond James' summary policies relating to research analyst independence can be obtained by contacting any Raymond James & Associates or Raymond James Financial Services office (please see** www.raymondjames.com **for office locations) or by calling (727) 567-1000, toll free (800) 237-5643 or sending a written request to the Equity Research Library, Raymond James & Associates, Inc., Tower 3, 6th Floor, 880 Carillon Parkway, St. Petersburg, FL 33716.**

The views expressed in this report accurately reflect the personal views of the analyst(s) covering the subject securities. No part of said person's compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report. In addition, said analyst has not received compensation from any subject company in the last 12 months.

Investors should consider this report as only a single factor in making their investment decision.

For clients in the United Kingdom:

For clients of Raymond James & Associates (RJA) and Raymond James Financial International, Ltd. (RJFI): This report is for distribution only to persons who fall within Articles 19 or Article 49(2) of the Financial Services and Markets Act (Financial Promotion) Order 2000 as investment professionals and may not be distributed to, or relied upon, by any other person.

For clients of Raymond James Investment Services, Ltd.: This report is intended only for clients in receipt of Raymond James Investment Services, Ltd.'s Terms of Business or others to whom it may be lawfully submitted.

For purposes of the Financial Services Authority requirements, this research report is classified as objective with respect to conflict of interest management. RJA, Raymond James Financial International, Ltd., and Raymond James Investment Services, Ltd. are authorized and regulated in the U.K. by the Financial Services Authority.

For institutional clients in the European Economic Area (EEA) outside of the United Kingdom:

This document (and any attachments or exhibits hereto) is intended only for EEA institutional clients or others to whom it may lawfully be submitted.

Additional information is available on request.

Life and Health Insurance
Industry Brief

Steven D. Schwartz, CFA
(312) 612-7686
Steven.Schwartz@RaymondJames.com

Jason Royer
Senior Research Associate
(312) 612-7688

RAYMOND JAMES®

EQUITY RESEARCH

July 7, 2008

SEC Index Annuity Proposal: We Still Think the Staff Got It Wrong

The acceptance by the SEC Board of Governors of the SEC staff's proposal to regulate index annuities as securities kicks off what is likely to be a long battle over the definition of what is insurance and what is not, in the U.S. Court system – a battle that has not been truly joined since the 1960s.

Following the reading of the SEC's full 96 page proposal, we continue to believe that index annuity providers have got it right. Unless the SEC can prove all index annuities are marketed as investments rather than exempt annuity products, we believe that index annuities will ultimately be shown to be exempt under the Securities Act of 1933.

Although the SEC staff is correct that the index annuity contract holder bears the risk of market fluctuations in excess of the guaranteed minimum, we believe the investment risk inherent in managing the general account assets to be the predominate risk. Further, it seems apparent that index annuities do not fit "squarely the sort of problems that the Securities Act and the Investment Act were devised to deal with," but rather more fairly suit the functions of state insurance regulation – to prescribe statutory limitations on investments and to monitor solvency and reserves.

Please read disclosure/risk information on page 7 and Analyst Certification on page 8.

The Raymond James Financial Center, 880 Carillon Parkway, St. Petersburg, FL 33716
Institutional clients may call for additional information:
Research 800-237-5643 • Trading 800-237-8426

RAYMOND JAMES®
& ASSOCIATES, INC.
Member New York Stock Exchange/SIPC

What Are We Arguing About Here?

What is under consideration is Section 3(a) of the Securities Act. To paraphrase the Securities Act (to quote verbatim would be way too long), Sec. 3(a)(10) states that any security approved by an insurance commissioner (among others) is exempt from the requirements of the Act (including registration). Sec. 3(a)(8) states that any insurance, endowment policy, or annuity contract issued by a corporation subject to the supervision of the insurance commissioner (again among others) is exempt.

Unfortunately, that's it. The SEC, insurance industry, and the Supreme Court have been trying to read Congress' mind ever since. The Supreme Court, in its wisdom, has recognized that just because an insurance company calls something an annuity, doesn't mean the product is automatically exempt.

Two cases have been of key importance: *S.E.C. vs. VALIC* (1959) and *S.E.C. v. United Benefit Life* (1967). The SEC proposal cites both cases a number of times.

A Question of Risk: Who's Got It and How Much?

In *VALIC*, the Supreme Court took its first real look at the Sec. 3(a)(8) exemption. VALIC (now owned by American International Group) had issued a non-registered variable annuity claiming the exemption on the basis: a) that it was an insurance company regulated by an insurance commissioner, and b) the assumption of mortality risk (the promise of income payments over the life of the annuitant).

The Court found for the SEC. The majority decision noted that the variable annuity places all the investment risk on the policyholder since he or she cannot look forward to a fixed monthly or yearly amount in his or her advancing years absent some guarantee of fixed income. In addition, the majority concluded that the concept of insurance involved some risk-taking on the part of the company and that the risk of mortality was not substantial. Finally, the majority states that, "...in common understanding 'insurance' involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts," and that variable annuities "guarantee nothing to the annuitant except an interest in a portfolio of common stocks or other equities – an interest that has a ceiling but no floor."

In a concurring opinion, Justice Brennan states that while these [VALIC's] contracts contain insurance features, they contain to a very substantial degree elements of investment contracts as administered by equity investment trusts.

In *United Benefit Life*, the Court expanded on the matter of investment risk.

At the time, United Benefit Life offered what it called a "Flexible Fund Contract." Under the contract, the premium, less a deduction for expenses (the net premium), was placed in a Flexible Fund account which United maintained separately from its other funds. The "Flexible Fund" was invested with the object of producing capital gains as well as an interest return, and the major part of the fund was invested in common stock. The purchaser, at all times before maturity, was entitled to his proportionate share of the total fund and could withdraw all or part of his interest. The purchaser was also entitled to an alternative cash value measured by a percentage of his net premiums, which gradually increased from 50% of that sum in the first year to 100% after 10 years. At maturity, the purchaser could elect to receive the cash value of his policy, measured by either his interest in the fund or by the net premium guarantee. He could choose to convert his interest into a life annuity under conditions specified in the contracts. While the dollar benefits to be received would vary with the cash value at maturity, the net premium guarantee would guarantee a certain amount of fixed amount payment life annuity would be available at maturity.

The Court held that the company's "Flexible Fund" contract did not come within the Sec. 3(a)(8) exemption ruling that "...the assumption of an investment risk cannot, by itself, create an insurance provision under the federal definition." Additionally, the Court stated that "...a difference between a contract which to some degree is insured and a contract of insurance must be recognized." The Court noted that although the net premium guarantee substantially reduced the investment risk to the contract holder, the actual risk assumed by the insurer was very low, as the guaranteed minimum at maturity was "substantially less than that guaranteed by the same premiums in a conventional deferred annuity contract."

VALIC states that there must be some investment risk transfer from the policyholder to the insurance company to qualify for the exemption. *United Benefit Life* states that the investment risk assumed by the insurer must predominate over the investment risk assumed by the policyholder.

What Did Congress Intend? Brennan's Pragmatism
Returning to the concurring opinion in *VALIC*, Justice Brennan offered up a more pragmatic test, noting that the Securities Act of 1933 and the Investment Company Act of 1940 were specifically drawn to exclude "any insurance policy" and "any annuity" and "any insurance company" from their coverage. These exclusions left these contracts and companies to the sole control of state regulators.

Brennan wrote that these exclusions existed, not out of the goodness of Congress' collective heart, but because "there then was a form of 'investment' known as insurance (including 'annuity contracts') which did not present very squarely the sort of problems that the Securities Act and the Investment Company Act were devised to deal with..."

The question, to Brennan, was whether a contract represented the type of "investment" that Congress was willing to leave to the state insurance regulators.

Brennan then argued that "one of the basic premises of state regulation would appear to be that in one sense an "investor in an annuity... not become a direct sharer in the company's investment experience; that his investment in the policy or contract be sufficiently protected to prevent this." However, where a company's obligation is not measured in a monetary promise but is "rather the present condition of [the company's] investment portfolio... historic functions of state insurance regulation become meaningless" as prescribed state regulatory limitations on investments and examination of solvency and reserves "become perfectly circular to the extent that there is no obligation to pay except in terms measured by one's portfolio."

Where there is no obligation to pay except in term of one's portfolio, according to Brennan, the provisions of the Investment Company Act of 1940 become more relevant.

Ultimately, rather than trying to define investment risk and degrees thereof, Brennan asks pragmatically, "Does a product fit state regulation or the provisions of the Investment Company Act?" If the latter, the contract is a security; if the former, Brennan saw an insurance product.

How Is It Marketed?
If there was one clear message from the Supreme Court, it came in *United Benefit Life*: if an otherwise exempt annuity is marketed like an investment, it's an investment. The Court ruled that the Flexible Fund did not come within the exemption since the "appeal to the purchaser is not on the usual basis of stability and security, but on the prospect of 'growth' through sound investment management...." and that "the terms of the offer shape the character of the instrument."

In summary, in *VALIC* and *United Benefit Life*, the Court has basically asked: 1) Who has the predominate risk – the insurer or the purchase? 2) Does the contract "fit" within the regulatory framework behind the Investment Company Act, or is it more in-line with the historic insurance framework? and 3) How is the contract marketed?

Safe Harbor Rule 151

In 1986, the SEC issued Safe Harbor Rule 151, which summarized (at least according to the SEC) case law as developed in both *VALIC* and *United Benefit Life,* while adding greater specificity with respect to the investment risk rule (an addendum added by the SEC). Rule 151 acknowledged that an insurer is deemed to assume the investment risk under an annuity contract if, among other things:

(1) the insurer:

   (a) guarantees the principal amount of purchase payments and credited interest, less any deduction for sales, administrative, or other expenses or charges; and
   (b) credits a specified interest rate that is at least equal to the minimum rate required by applicable state law and

(2) the insurer guarantees that the rate of any interest to be credited in excess of the guaranteed minimum rate described in paragraph 1(b) will not be modified more frequently than once per year.

The SEC staff now says that indexed annuity providers are not entitled to rely on Rule 151 because indexed annuities fail to satisfy the second requirement. The staff argues that it was the SEC's intent to allow insurers to make limited use of index features, provided that the insurer specifies an index to which it would refer, no more often than annually, to determine the excess interest rate that it would guarantee for the **next** 12-month or longer period. Index annuities, according to the staff, do not meet this requirement as the actual rate of interest is not guaranteed for the proceeding 12-months; rather, only the mechanism used to determine the excess interest credited is fixed, while the rate of excess interest to be awarded is computed retroactively.

Our own view is that both interpretations of Requirement 2 could be thought to be covered by the actual language. That said, it's the SEC's interpretation – they can say what it means. For what it's worth, there is nothing in either *VALIC* or *United Benefit Life* that addresses either the question of excess interest credited or the number of times per year the rate could be altered. And in fact, the staff acknowledges, in notes to the proposal, that it was aware of one court that interpreted Requirement 2 in-line with the industry understanding [*Malone v Addison Insurance Marketing* (2002)].

Safe Harbor Rule 151A: Risk Transfer Not Substantial Enough

Given that the Staff believes that indexed annuities are not protected by Rule 151, the Staff proposed Rule 151A, which would solely define indexed annuities as not exempt under Sec. 3(a)(8) of the Securities Act if:

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

(2) Amounts payable by the insurance company under the contract are more likely than not to exceed the amounts guaranteed under the contract.

The Staff argues that the first test defines a class of securities that it believes require further scrutiny because they implicate the factors articulated by the Supreme Court as important in determining whether the Sec. (3)(8) exemption is applicable. When payments under a contract are calculated by reference to the performance of a security or securities, rather than being paid in a fixed amount, at least some investment risk relating to the performance of the securities is assumed by the purchaser. In addition, the contract may be marketed on the basis of the potential for growth offered by investments in the securities (the clear no-no under *United Benefit Life*).

We don't have a problem with the first test. Although the Supreme Court doesn't even allude to such a test, the staff conclusion seems logical. There is some risk that is not being transferred to the insurance company. The question, as noted in *VALIC* and *United Benefit Life*, is how much risk has been transferred?

Test 2 attempts to answer that question. The staff view is that if expected returns are greater than guaranteed returns, then the policyholder is taking the investment risk since "by purchasing an indexed annuity, the purchaser assumes the risk of an uncertain and fluctuating financial instrument in exchange for exposure to future, securities-linked returns." And while indexed annuity contracts provide some protection against the risk of loss, these provisions do not eliminate a purchaser's exposure to risk under the contract. According to the staff, "the value of the purchaser's investment is more likely than not to depend on movements in the underlying securities index..." Hence, indexed annuities have aspects of insurance, but "we do not believe these protections are substantial enough."

Thus, according to the staff, there is no true risk transfer to the insurer, or at a minimum, the risk assumed by the policyholder predominates the risk assumed by the insurer.

Congressional Objective
Following Brennan's concurring opinion in *VALIC*, the SEC staff makes its case that indexed annuities are in many ways similar to mutual funds, variable annuities, and other securities, because they may contain "to a very substantial degree elements of investment contracts." Additionally, purchasers of index annuities are "vitally interested in the investment experience."

Because of these similarities, the staff believes that the "regulatory objectives that Congress was attempting to achieve when it enacted the Securities Act are present..."

Marketing
As mentioned earlier, the staff believes that index annuities may be marketed on the basis of the potential for growth offered by investments in securities.

Our Thoughts

Risk
Clearly, the question of risk is of primary importance. Is there risk transfer and is it enough?

While we agree with the staff that "the majority of the investment risk for the fluctuating, equity-linked portion of the return is borne by the individual purchaser," we do not accept that this is the sole risk inherent in the index annuity contract. Our thoughts run towards the following question: If the individual attempted to recreate the contract himself rather than buy a product from a life insurer, how would his risk profile change?

Excluding the tax deferral of inside build up, an individual could easily re-create a traditional fixed, variable, or indexed annuity.

In re-creating a traditional fixed annuity, the individual would simply buy and maintain a portfolio of fixed income securities. He or she would face the myriad risks that generally are considered part of "investment risk," including, but not limited to: credit risk and mortgage risk, interest rate risk, liquidity risk, disintermediation risk, prepayment and call risk, and asset/liability management risk. If the individual decided to invest in some foreign holdings, he or she would face currency risk, as well. Clearly, the decision to buy a traditional fixed annuity, rather than create such a product oneself, transfers the predominate amount, if not all, of what constitutes investment risk to the insurer.

The lack of risk transfer in a variable annuity is even easier to understand. The contract purchaser bears the same risk whether he or she buys a mutual fund or a variable annuity with a subaccount that mimics a fund. Market and business risk remain with the individual in both scenarios.

While somewhat more difficult, an individual can recreate an indexed annuity, as well. For a typical 100% participation rate product with a cap, the individual would use a small portion of his or her principal to buy a bull spread, with the remaining principal invested in bonds and other fixed income securities. In purchasing the indexed annuity, the individual accepts that the equity-linked portion of the return is fluctuating. But by recreating the indexed annuity, the individual not only accepts this risk but adds the substantial risks inherent in a traditional fixed annuity: credit risk and mortgage risk, interest rate risk, liquidity risk, disintermediation risk, prepayment and call risk, and asset/liability management risk. In addition, the individual would be potentially accepting other forms of "investment risk" such as basis risk and/or counterparty risk.

While the contract holder accepts the risk of fluctuations of the equity-linked portion of the return, he faces no risk of loss (in fact, will likely be guaranteed a small compound annual return over the surrender charge period), and will suffer no decline in account value if the reference index is negative for a year (an important difference between indexed annuities and mutual funds/variable annuities with guarantee riders).

Hence, within the entire investment program, we think the risk assumed by the insurer predominates that assumed by the investor.

We fail to see how the staff could have completely ignored the risk inherent in the general account in the current investment environment of defaults, write downs, and declining real estate markets. In fact, we found it somewhat ironic that, in the Group Open Meeting that took place on Wednesday, June 25, the staff's indexed annuity proposal completely ignored the risk inherent in managing the general account assets, after immediately following a proposal to de-emphasize reliance on rating agencies in SEC rule-making in light of the agencies' inability to accurately assess the credit risk inherent in numerous subprime based asset classes.

Further, given the lack of exposure to a decline in account value, we disagree with the assertion that the indexed annuity contract holder faces many of the same risks and rewards that investors assume when investing their money in mutual funds, variable annuities, and other securities.

Congressional Intent
We also disagree with the assertion that the indexed annuity contract falls outside of the form that Congress was willing to leave exclusively to state insurance regulators.

First, unlike with a variable annuity, the indexed annuity contract holder relies on the solvency of the company and the adequacy of reserves necessary to meet the company's obligation to him. These are matters well within the purview of state regulation.

Second, the indexed annuity holder is not a direct sharer in the company's investment experience – a basic premise in favor of state regulation, according to Justice Brennan.

Third, many of the provisions of the Investment Company Act, which is informed by policies that are relevant for mutual funds and variable annuities, are not relevant for indexed annuities. The provisions of the Act call for, among other things, regulation of: investment policies and operating practices; the relationships between the company and its investment adviser, including fees and provisions for the termination of a contract; trading practices; changes in investment policy; the issuance of senior securities; and proxies and voting trusts – none of which pertain in the slightest to indexed annuities.

Marketing
In all honesty, this is where we believed that the SEC would, and should, concentrate – laying down guidelines for what indexed annuity providers can and cannot say, without stepping over the line. Instead, the staff simply stated that the potential for abuse existed with indexed annuities; therefore, the products should not be considered exempt.

We do not believe that the potential for abuse qualifies as reason to refuse the Sec. 3(a)(8) exemption. As the Court says in *United Benefit Life*, it is "not inappropriate that promoters' offerings be judged as being what they were represented to be." The Court did not say that promoters' offerings should be judged based on what they **might** be represented to be.

While indexed annuities may offer competition to variable annuities and mutual funds at the margin, particularly for those who may not be comfortable with the risks of both, we believe index annuities primarily offer competition to other "safe money" alternatives such as certificates of deposits and conventional fixed annuities. Brochures we have seen indicate the potential to do better than safe money alternatives while stressing traditional insurance features such as safety of premium, tax deferral, avoidance of probate, liquidity, and guaranteed income.

In *Malone*, the court stated as much, noting that marketing materials provided by the indexed annuity provider did not promote "growth through professionally managed investment," (as advertised by United Benefit Life) but only the company's own sound financial management and the stability and flexibility of its products.

Summary
In summary, we think the SEC staff's regulatory zeal has been misplaced. Although marketing abuses undoubtedly occur, this is not an appropriate reason to declare that index annuities should be treated as investments.

While we acknowledge that individuals who purchase indexed annuities are exposed to investment risk (the volatility of the underlying securities index), we do not believe this risk to be predominate when assessing the entire investment program. The staff's concentration solely on the potential for fluctuating returns above the minimum guarantees at the expense of failing to acknowledging the risk inherent in managing the general account assets, particularly in this investment environment, baffles us.

Further, we believe that index annuities fit best within the insurance regulatory scheme – with its emphasis on solvency and the regulation of general account assets and reserves. We do not believe that index annuities fit well with many of the provisions of the Investment Company Act.

Nor do we believe that the potential for marketing index annuities as investments necessitates regulating index annuities as securities. The SEC staff would have been better served in laying down guidelines to ensure that annuity producers do not cross the line into investment promoters.

Important Investor Disclosures

Strong Buy (SB1)................ Expected to appreciate and produce a total return of at least 15% and outperform the S&P 500 over the next six months. For higher yielding and more conservative equities, such as REITs and certain MLPs, a total return of at least 15% is expected to be realized over the next 12 months.

Outperform (MO2)............... Expected to appreciate and outperform the S&P 500 over the next 12 months. For higher yielding and more conservative equities, such as REITs and certain MLPs, an Outperform rating is used for securities where we are comfortable with the relative safety of the dividend and expect a total return modestly exceeding the dividend yield over the next 12 months.

Market Perform (MP3).......... Expected to perform generally in line with the S&P 500 over the next 12 months and is potentially a source of funds for more highly rated securities.

Underperform (MU4)........... Expected to underperform the S&P 500 or its sector over the next six to 12 months and should be sold.

Out of approximately 690 rated stocks in the Raymond James coverage universe, 57% have Strong Buy or Outperform ratings (Buy), 36% are rated Market Perform (Hold) and 6% are rated Underperform (Sell). Within those rating categories, 30% of the Strong Buy- or Outperform (Buy) rated companies either currently are or have been Raymond James Investment Banking clients within the past three years; 18% of the Market Perform (Hold) rated companies are or have been clients and 9% of the Underperform (Sell) rated companies are or have been clients.

Suitability ratings are not assigned to stocks rated Underperform (Sell). Projected 12-month price targets are assigned only to stocks rated Strong Buy or Outperform.

Suitability Categories (SR)

Total Return (TR)................ Lower risk equities possessing dividend yields above that of the S&P 500 and greater stability of principal.

Growth (G)............................ Low to average risk equities with sound financials, more consistent earnings growth, possibly a small dividend, and the potential for long-term price appreciation.

Aggressive Growth (AG)..... Medium or higher risk equities of companies in fast growing and competitive industries, with less predictable earnings and acceptable, but possibly more leveraged balance sheets.

High Risk (HR)...................... Companies with less predictable earnings (or losses), rapidly changing market dynamics, financial and competitive issues, higher price volatility (beta), and risk of principal.

Venture Risk (VR)................ Companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, and a substantial risk of principal.

Analyst Holdings and Compensation: Equity analysts and their staffs at Raymond James are compensated based on a salary and bonus system. Several factors enter into the bonus determination including quality and performance of research product, the analyst's success in rating stocks versus an industry index, and support effectiveness to trading and the retail and institutional sales forces. Other factors may include but are not limited to: overall ratings from internal (other than investment banking) or external parties and the general productivity and revenue generated in covered stocks.

Raymond James Relationships: RJA expects to receive or intends to seek compensation for investment banking services from the subject companies in the next three months.

General Risk Factors: Following are some general risk factors that pertain to the projected 12-month target prices included on our research for stocks rated Strong Buy or Outperform: (1) Industry fundamentals with respect to customer demand or product / service pricing could change and adversely impact expected revenues and earnings; (2) Issues relating to major competitors or market shares or new product expectations could change investor attitudes toward the sector or this stock; (3) Unforeseen developments with respect to the management, financial condition or accounting policies or practices could alter the prospective valuation; or (4) External factors that affect the U.S. economy, interest rates, the U.S. dollar or major segments of the economy could alter investor confidence and investment prospects.

Specific Investment Risks Related to the Industry or Issuer

Life and Health Insurance Industry Risks
Life and Health Insurers face many risks including but not limited to poor equity market performance (and the related effect on fees, guaranteed minimum death benefit reserves, and deferred acquisition cost amortization), interest spread compression, deteriorating credit quality, adverse mortality and morbidity experience, and continuing pressure from rating agencies. Providers of tax-deferred asset accumulation products face uncertainty in the face of passage of the dividend tax cut, which could lead to a decline in sales as insurance products would, to some extent, lose the advantage of tax-deferral over equity mutual funds and direct equity investment.

Additional Risk and Disclosure information, as well as more information on the Raymond James rating system and suitability categories, is available at www.rjcapitalmarkets.com/SearchForDisclosures_main.asp. Copies of research or Raymond James' summary policies relating to research analyst independence can be obtained by contacting any Raymond James & Associates or Raymond James Financial Services office (please see www.raymondjames.com for office locations) or by calling (727) 567-1000, toll free (800) 237-5643 or sending a written request to the Equity Research Library, Raymond James & Associates, Inc., Tower 3, 6th Floor, 880 Carillon Parkway, St. Petersburg, FL 33716.

The views expressed in this report accurately reflect the personal views of the analyst(s) covering the subject securities. No part of said person's compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report. In addition, said analyst has not received compensation from any subject company in the last 12 months.

Investors should consider this report as only a single factor in making their investment decision.

For clients in the United Kingdom:

For clients of Raymond James & Associates (RJA) and Raymond James Financial International, Ltd. (RJFI): This report is for distribution only to persons who fall within Articles 19 or Article 49(2) of the Financial Services and Markets Act (Financial Promotion) Order 2000 as investment professionals and may not be distributed to, or relied upon, by any other person.

For clients of Raymond James Investment Services, Ltd.: This report is intended only for clients in receipt of Raymond James Investment Services, Ltd.'s Terms of Business or others to whom it may be lawfully submitted.

For purposes of the Financial Services Authority requirements, this research report is classified as objective with respect to conflict of interest management. RJA, Raymond James Financial International, Ltd., and Raymond James Investment Services, Ltd. are authorized and regulated in the U.K. by the Financial Services Authority.

For institutional clients in the European Economic Area (EEA) outside of the United Kingdom:

This document (and any attachments or exhibits hereto) is intended only for EEA institutional clients or others to whom it may lawfully be submitted.

Additional information is available on request.

Meeting with Maryland Insurance Commissioner Ralph Tyler

July 28, 2008

Table of Contents

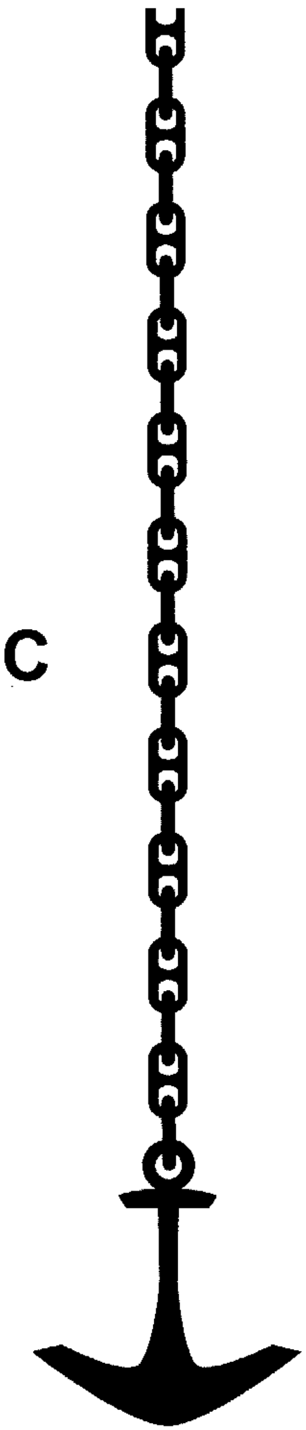
Rule 151A Old Mutual Opposition PowerPoint

OLD MUTUAL
INVEST INSURE INNOVATE

A PRESENTATION TO:

Maryland Insurance Administration

Old Mutual's Response to SEC Rule 151A



PRESENTED BY:

Eric Marhoun

July 28, 2008

Executive Summary

- Rule 151A is unnecessary and overly burdensome.
- Rule 151A ignores the efforts of State Insurance Commissioners in addressing sales practices. (Maryland passed the Model Reg in 07)
- Rule 151A is so broadly written that it would apply to all annuities, and ultimately all interest-crediting life insurance.
- Rule 151A would have an adverse impact upon Old Mutual and its 250 employees, 2000 producers and 230 agencies in Maryland.
- Maryland is an important state in this critical battle against unnecessary federal regulation because it is home to the nation's 4th largest writer of both Indexed Annuities and Indexed Life.
- We need your help – and that of the NAIC – to battle this encroachment upon state insurance regulation.

OLD MUTUAL
INVEST INSURE INNOVATE

Background on Old Mutual

- Largest life insurance company domiciled in Maryland.
- Assets of approximately $17 billion; nearly 50% in annuity reserves.
- 4th largest writer of Fixed Indexed Annuity (FIA) business in the U.S.
- 4th largest writer of Fixed Indexed Universal Life business in the U.S.
- 230 employees, 2000 producers, 230 agencies in Maryland

OLD MUTUAL
INVEST INSURE INNOVATE

Background on Annuities

- A leading retirement financial product offered by life insurance companies offering:
  - Retirement savings
  - Probate efficiencies
  - Guaranteed income options like annuitization
- Benefits of FIAs:
  - Guaranteed accumulation
  - Tax deferral
  - Withdrawal or annuitization rights
- Regulated by state insurance departments. 3 basic types: FIAs, declared rate and VAs.
- Growth from @$4B in 1998 to $25B in 2007; 10% of annuity sales

Overview of Rule 151A

- Recently proposed by the SEC without any real warning after over a decade of non-action by the SEC.
- Imposes an unprecedented two-prong test that could be read to apply to nearly all non-variable annuities and, ultimately, to all interest-crediting life insurance policies.
- Applies to insurance products which have been regulated as insurance products since their inception over 12 years ago.
- Ignores State Insurance Department regulation developed over the past 5-6 years applicable to FIA sales practices. **(Maryland recently adopted the Model Annuity Suitability Regulation.)**

OLD MUTUAL
INVEST INSURE INNOVATE

Fixed Index Annuities *not* Securities

- Fixed Index Annuities (FIAs) are fixed annuities and have no market risk.
- The 151A release incorrectly equates the purchase of an FIA with an investment in a market index.
- The only difference between a traditional declared rate annuity and an FIA is the manner in which annual interest is calculated.
- In both cases, the full contract value, including premium plus interest credited in all prior years, is ***not*** exposed to ***any*** market risk.
- The consumer cannot lose money due to the market.

OLD MUTUAL
INVEST INSURE INNOVATE

Comparison of Annuities

	Declared Rate Annuity	Fixed Index Annuity	Variable Annuity
Guarantee of premium and minimum interest	✓	✓	
Annual interest at rates declared by the insurer	✓		
Annual interest linked to an external index		✓	
Consumer bears Market Risk			✓
Tax-deferred growth	✓	✓	✓
No up front sales charges or annual fees	✓	✓	
Penalty-free 10% annual withdrawals starting in yr 2	✓	✓	✓
Penalty-free systematic interest withdrawals	✓	✓	✓
Surrender charges apply for withdrawals above 10%, waived at death	✓	✓	✓
Additional liquidity upon nursing home confinement or terminal illness or unemployment	✓	✓	

Why Consumers Buy FIAs

- The SEC 151A release incorrectly concludes that FIAs are marketed and purchased primarily for market gains.
- FIAs are purchased primarily for safety of premium with the potential for additional credited interest.
- FIAs offer consumers the opportunity to earn a somewhat higher interest rate than would be paid on a declared rate product.

Consumers Bear *no* Investment Risk

- The 151A release mistakenly states that an FIA purchaser assumes investment risk comparable to a variable annuity or mutual fund. **This is wrong! This has led to a totally unprecedented proposed Rule with 2-prongs having no basis in law.**
- FIA investment risk is limited to fluctuations in annual interest and subject to a guaranteed minimum.
- Prong 1 – reference to a Security: Many insurance and bank products not regulated as securities have fluctuating levels of annual interest – including e.g. indexed certificates of deposit.
- Prong 2 – more likely than not in excess of guarantee: Many insurance products not regulated as securities provide for "excess value" above guaranteed minimums.

OLD MUTUAL
INVEST INSURE INNOVATE

Insurer Investment Risk

- Fixed annuity insurers manage their "general account" securities to fund guaranteed FIA contract values.
- None of the risk of loss on general account securities is passed through to consumers.
- Variable annuities are "separate account" products where all investment experience of securities within the account is passed through to consumers, whether gain or loss.

An Unnecessary Layer of Regulation

- Insurance Producers are already licensed and regulated by State Insurance Commissioners.
- Insurance Companies have duty to develop system of supervision with regard to annuity suitability.
- Insurance regulations impose disclosure and advertising requirements upon all annuity sales.
- What would be added by SEC regulation?

OLD MUTUAL
INVEST INSURE INNOVATE

Insurance Regulation of Sales Practices

- The 151A release incorrectly states that the main focus of state insurance regulation is insurer financial solvency.
- State insurance regulation also covers (with some variation by state):
  - Annuity disclosure requirements
  - Suitability reviews
  - "Free-look" periods
  - Advertising
  - Unfair trade practices
  - Regulation of "replacements", or exchanges of annuities
  - Market conduct reviews of insurers
  - Levels of consumer guarantees in annuities/surrender charges
  - Agent licensing and training (specific FIA training in some states)
  - Insurance agent penalties for violations of sales rules

Complaints

- The 151A release states – with no evidence -- that complaints and abusive FIA sales practices are sharply increasing.
- NAIC complaint data shows fewer complaints regarding FIAs than VAs or other types of annuities.
- NASAA maintains no complaint data that we have been able to locate.
- The NBC Dateline segment on FIAs featured only one actual consumer.

OLD MUTUAL
INVEST INSURE INNOVATE

Insurance Regulation is Working

- The 151A release incorrectly states that fraud and abuse in sales to the elderly are closely linked to FIAs.
- Securities regulation is no more effective than state insurance regulation in protecting seniors from unscrupulous sales practices in sales of financial products.
- State insurance regulators are implementing new and enhanced protections for seniors, just as securities regulators are.
- SEC proposal will derail progress on sales practice regulation.

Old Mutual

- No Old Mutual FIA policyholder has ever lost a dime of contract value as a result of market volatility.
- Old Mutual requires the use of clear and concise disclosures in all sales in all states.
- Old Mutual conducts suitability reviews of all sales in all states.
- Old Mutual has a complaint ratio of less than 0.2% of all FIA contract-holders.
- Old Mutual trains its agents in suitability and disclosure in FIA sales.

What You Can Do

- Get informed and involved – consider Life "A" Committee representation.
- Contact Commissioner Susan Voss of Iowa to learn of the leading role she is taking in opposing Rule 151A and promoting good sales practices.
- Support NAIC resolution under consideration opposing Rule 151A and supporting NAIC model regulations and other efforts to improve sales practices.

SEC Proposed Rule 151A and Release

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230 and 240

[Release Nos. 33-8933, 34-58022; File No. S7-14-08]

RIN 3235-AK16

INDEXED ANNUITIES AND CERTAIN OTHER INSURANCE CONTRACTS

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing a new rule that would define the terms "annuity contract" and "optional annuity contract" under the Securities Act of 1933. The proposed rule is intended to clarify the status under the federal securities laws of indexed annuities, under which payments to the purchaser are dependent on the performance of a securities index. The proposed rule would apply on a prospective basis to contracts issued on or after the effective date of the rule. We are also proposing to exempt insurance companies from filing reports under the Securities Exchange Act of 1934 with respect to indexed annuities and other securities that are registered under the Securities Act, provided that the securities are regulated under state insurance law, the issuing insurance company and its financial condition are subject to supervision and examination by a state insurance regulator, and the securities are not publicly traded.

DATES: Comments should be received on or before September 10, 2008.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-14-08 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-14-08. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Michael L. Kosoff, Attorney, or Keith E. Carpenter, Senior Special Counsel, Office of Disclosure and Insurance Products Regulation, Division of Investment Management, at (202) 551-6795, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5720.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is proposing to add rule 151A under the Securities Act of 1933

("Securities Act")[1] and rule 12h-7 under the Securities Exchange Act of 1934 ("Exchange Act").[2]

---

[1] 15 U.S.C. 77a et seq.

[2] 15 U.S.C. 78a et seq.

Table of Contents

I. EXECUTIVE SUMMARY

We are proposing a new rule that is intended to clarify the status under the federal securities laws of indexed annuities, under which payments to the purchaser are dependent on the performance of a securities index. Section 3(a)(8) of the Securities Act provides an exemption under the Securities Act for certain insurance contracts. The proposed rule would prospectively define certain indexed annuities as not being "annuity contracts" or "optional annuity contracts" under this insurance exemption if the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract.

The proposed definition would hinge upon a familiar concept: the allocation of risk. Insurance provides protection against risk, and the courts have held that the allocation of investment risk is a significant factor in distinguishing a security from a contract of insurance. The Commission has also recognized that the allocation of investment risk is significant in determining whether a particular contract that is regulated as insurance under state law is insurance for purposes of the federal securities laws.

Individuals who purchase indexed annuities are exposed to a significant investment risk – i.e., the volatility of the underlying securities index. Insurance companies have successfully utilized this investment feature, which appeals to purchasers not on the usual insurance basis of stability and security, but on the prospect of investment growth. Indexed annuities are attractive to purchasers because they promise to 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.

When the amounts payable by an insurer under an indexed annuity are more likely than not to exceed the amounts guaranteed under the contract, the majority of the investment risk for the fluctuating, equity-linked portion of the return is borne by the individual purchaser, not the insurer. 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.

The federal interest in providing investors with disclosure, antifraud, and sales practice protections arises when individuals are offered indexed annuities that expose them to securities investment risk. Individuals who purchase such indexed annuities assume many of the same risks and rewards that investors assume when investing their money in mutual funds, variable annuities, and other securities. However, a fundamental difference between these securities and indexed annuities is that – with few exceptions – indexed annuities historically have not been registered as securities. As a result, most purchasers of indexed annuities have not received the benefits of federally mandated disclosure and sales practice protections.

We have determined that providing greater clarity with regard to the status of indexed annuities under the federal securities laws would enhance investor protection, as well as provide greater certainty to the issuers and sellers of these products with respect to their obligations under the federal securities laws. Accordingly, we are proposing a new definition of "annuity contract" that, on a prospective basis, would define a class of indexed annuities that are outside the scope of Section 3(a)(8). With respect to these annuities, investors would be entitled to all the protections of the federal securities laws, including full and fair disclosure and sales practice protections.

We are aware that many insurance companies, in the absence of definitive interpretation or definition by the Commission, have of necessity acted in reliance on their own analysis of the legal status of indexed annuities based on the state of the law prior to this release. Under these circumstances, we do not believe that insurance companies should be subject to any additional legal risk relating to their past offers and sales of indexed annuities as a result of our proposal today or its eventual adoption. Therefore, we are also proposing that the new definition apply prospectively only – that is, only to indexed annuities that are issued <u>on or after</u> the effective date of our final rule.

Finally, we are proposing a new exemption from Exchange Act reporting that would apply to insurance companies with respect to indexed annuities and certain other securities that are registered under the Securities Act and regulated as insurance under state law. We believe that this exemption is necessary or appropriate in the public interest and consistent with the protection of investors. Where an insurer's financial condition and ability to meet its contractual obligations are subject to oversight under state law, and where there is no trading interest in an insurance contract, the concerns that periodic and current financial disclosures are intended to address are generally not implicated. Rather, investors who purchase these securities are primarily affected by issues relating to the insurer's financial ability to satisfy its contractual obligations – issues that are addressed by state law and regulation.

II. BACKGROUND

Beginning in the mid-1990s, the life insurance industry introduced a new type of annuity, referred to as an "equity-indexed annuity," or, more recently, "fixed indexed annuity" (herein "indexed annuity"). Amounts paid by the insurer to the purchaser of an indexed annuity are based, in part, on the performance of an equity index or another securities index, such as a bond index.

The status of indexed annuities under the federal securities laws has been uncertain since their introduction in the mid-1990s. Under existing precedents, the status of each indexed annuity is determined based on a facts and circumstances analysis of factors that have been articulated by the U.S. Supreme Court.[3] Insurers have typically marketed and sold indexed annuities without complying with the federal securities laws, and sales of the products have grown dramatically in recent years. This growth has, unfortunately, been accompanied by growth in complaints of abusive sales practices. These include claims that the often-complex features of these annuities have not been adequately disclosed to purchasers, as well as claims that rapid sales growth has been fueled by the payment of outsize commissions that are funded by high surrender charges imposed over long periods, which can make these annuities particularly unsuitable for seniors and others who may need ready access to their assets.

We have observed the development of indexed annuities for some time, and we have become persuaded that guidance is needed with respect to their status under the federal securities laws. Today, we are proposing rules that are intended to provide greater clarity regarding the scope of the exemption provided by Section 3(a)(8). We believe our proposed action is consistent with Congressional intent in that the proposed definition would afford the disclosure and sales practice protections of the federal securities laws to purchasers of indexed annuities who are more likely than not to receive

---

3 SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) ("VALIC"); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) ("United Benefit").

payments that vary in accordance with the performance of a security. In addition, the proposed rules are intended to provide regulatory certainty and relief from Exchange Act reporting obligations to the insurers that issue these indexed annuities and certain other securities that are regulated as insurance under state law. We base our proposed exemption on two factors: first, the nature and extent of the activities of insurance company issuers, and their income and assets, and, in particular, the regulation of these activities and assets under state insurance law; and, second, the absence of trading interest in the securities.

A. Description of Indexed Annuities

An indexed annuity is a contract issued by a life insurance company that generally provides for accumulation of the purchaser's payments, followed by payment of the accumulated value to the purchaser either as a lump sum, upon death or withdrawal, or as a series of payments (an "annuity"). During the accumulation period, the insurer credits the purchaser with a return that is based on changes in a securities index, such as the Dow Jones Industrial Average, Lehman Brothers Aggregate U.S. Index, Nasdaq 100 Index, or Standard & Poor's 500 Composite Stock Price Index. The insurer also guarantees a minimum value to the purchaser.[4]

[4] Financial Industry Regulatory Authority, Inc. ("FINRA"), Equity-Indexed Annuities – A Complex Choice (updated Apr. 22, 2008), available at: http://www.finra.org/InvestorInformation/InvestorAlerts/AnnuitiesandInsurance/Equity-IndexedAnnuities-AComplexChoice/P010614; National Association of Insurance Commissioners, Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities, at 9 (2007); National Association for Fixed Annuities, White Paper on Fixed Indexed Insurance Products Including 'Fixed Indexed Annuities' and Other Fixed Indexed Insurance Products, at 1 (2006), available at: http://www.nafa.us/pdfs/White%20Paper%20Final_11-10-06_All%20Inquiries.pdf; Jack Marrion, Index Annuities: Power and Protection, at 13 (2004).

Life insurance companies began offering indexed annuities in the mid-1990s.[5] Sales of indexed annuities for 1998 totaled $4 billion and grew each year through 2005, when sales totaled $27.2 billion.[6] Indexed annuity sales for 2006 totaled $25.4 billion and $24.8 billion in 2007.[7] In 2007, indexed annuity assets totaled $123 billion, 58 companies were issuing indexed annuities, and there were a total of 322 indexed annuities offered.[8] The specific features of indexed annuities vary from product to product. Some of the key features are as follows.

Computation of Index-Based Return

The purchaser's index-based return under an indexed annuity depends on the particular combination of features specified in the contract. Typically, an indexed annuity specifies all aspects of the formula for computing return in advance of the period for which return is to be credited, and the crediting period is generally at least one year long.[9] The rate of the index-based return is computed at the end of the crediting period, based on the actual performance of a specified securities index during that period, but the computation is performed pursuant to a mathematical formula that is guaranteed in advance of the crediting period. Common indexing features are described below.

- Index. Indexed annuities credit return based on the performance of a securities index, such as the Dow Jones Industrial Average, Lehman Brothers Aggregate

5 See National Association for Fixed Annuities, supra note 4, at 4.

6 NAVA, 2008 Annuity Fact Book, 57 (2008).

7 Id.

8 Id.

9 National Association for Fixed Annuities, supra note 4, at 13.

U.S. Index, Nasdaq 100 Index, or Standard & Poor's 500 Composite Stock Price Index. Some annuities permit the purchaser to select one or more indices from a specified group of indices.

- Determining Change in Index. There are several methods for determining the change in the relevant index over the crediting period.[10] For example, the "point-to-point" method compares the index level at two discrete points in time, such as the beginning and ending dates of the crediting period. Another method, sometimes referred to as "monthly point-to-point," combines both positive and negative changes in the index values from one month to the next during the crediting period and recognizes the aggregate change as the amount of index credit for the period, if it is positive. Another method compares an average of index values at periodic intervals during the crediting period to the index value at the beginning of the period. Typically, in determining the amount of index change, dividends paid on securities underlying the index are not included. Indexed annuities typically do not apply negative changes in an index to contract value. Thus, if the change in index value is negative over the course of a crediting period, no deduction is taken from contract value nor is any index-based return credited.[11]

---

[10] See FINRA, supra note 4; National Association of Insurance Commissioners, supra note 4, at 12-14; National Association for Fixed Annuities, supra note 4, at 9-10; Marrion, supra note 4, at 38-59.

[11] National Association of Insurance Commissioners, supra note 4, at 11; National Association for Fixed Annuities, supra note 4, at 5 and 9; Marrion, supra note 4, at 2.

- Portion of Index Change to be Credited. The portion of the index change to be credited under an indexed annuity is typically determined through the application of caps, participation rates, spread deductions, or a combination of these features.[12] Some contracts "cap" the index-based returns that may be credited. For example, if the change in the index is 6%, and the contract has a 5% cap, 5% would be credited. A contract may establish a "participation rate," which is multiplied by index growth to determine the rate to be credited. If the change in the index is 6%, and a contract's participation rate is 75%, the rate credited would be 4.5% (75% of 6%). In addition, some indexed annuities may deduct a percentage, or spread, from the amount of gain in the index in determining return. If the change in the index is 6%, and a contract has a spread of 1%, the rate credited would be 5% (6% minus 1%).

Surrender Charges

Surrender charges are commonly deducted from withdrawals taken by a purchaser.[13] The maximum surrender charges, which may be as high as 15-20%,[14] are imposed on surrenders made during the early years of the contract and decline gradually to 0% at the end of a specified surrender charge period, which may be in excess of 15

---

[12] See FINRA, supra note 4; National Association of Insurance Commissioners, supra note 4, at 10-11; National Association for Fixed Annuities, supra note 4, at 10; Marrion, supra note 4, at 38-59.

[13] See FINRA, supra note 4; National Association of Insurance Commissioners, supra note 4, at 3-4 and 11; National Association for Fixed Annuities, supra note 4, at 7; Marrion, supra note 4, at 31.

[14] The highest surrender charges are often associated with annuities in which the insurer credits a "bonus" equal to a percentage of purchase payments to the purchaser at the time of purchase. The surrender charge may serve, in part, to recapture the bonus.

years. Imposition of a surrender charge may have the effect of reducing or eliminating any index-based return credited to the purchaser up to the time of a withdrawal. In addition, a surrender charge may result in a loss of principal, so that a purchaser who surrenders prior to the end of the surrender charge period may receive less than the original purchase payments.[15] Many indexed annuities permit purchasers to withdraw a portion of contract value each year, typically 10%, without payment of surrender charges.

Guaranteed Minimum Value

Indexed annuities generally provide a guaranteed minimum value, which serves as a floor on the amount paid upon withdrawal, as a death benefit, or in determining the amount of annuity payments. The guaranteed minimum value is typically a percentage of purchase payments, accumulated at a specified interest rate, and may not be lower than a floor established by applicable state insurance law. Indexed annuities typically provide that the guaranteed minimum value is equal to at least 87.5% of purchase payments, accumulated at annual interest rate of between 1% and 3%.[16] Assuming a guarantee of 87.5% of purchase payments, accumulated at 1% interest compounded annually, it would take approximately 13 years for a purchaser's guaranteed minimum value to be 100% of purchase payments.

---

15 FINRA, supra note 4; Marrion, supra note 4, at 31.

16 National Association for Fixed Annuities, supra note 4, at 6.

Registration

Insurers typically have concluded that the indexed annuities they issue are not securities. As a result, virtually all indexed annuities have been issued without registration under the Securities Act.[17]

B. Marketing of Indexed Annuities

In the years after indexed annuities were first introduced, sales volumes were relatively small. In 1998, when sales totaled $4 billion, the impact of these products on both purchasers and issuing insurance companies was limited. As sales have grown in more recent years, with sales of $24.8 billion and total indexed annuity assets of $123 billion in 2007, these products have affected larger and larger numbers of purchasers. They have also become an increasingly important business line for some insurers.[18] In

---

17 In a few instances, insurers have registered indexed annuities as securities as a result of particular features, such as the absence of any guaranteed interest rate or the absence of a guaranteed minimum value. See, e.g., Pre-Effective Amendment No. 4 to Registration Statement on Form S-1 of PHL Variable Insurance Company (File No. 333-132399) (filed Feb. 7, 2007); Pre-Effective Amendment No. 1 to Registration Statement on Form S-3 of Allstate Life Insurance Company (File No. 333-105331) (filed May 16, 2003); Initial Registration Statement on Form S-2 of Golden American Life Insurance Company (File No. 333-104547) (filed Apr. 15, 2003).

18 See, e.g., Allianz Life Insurance Company of North America (Best's Company Reports, Allianz Life Ins. Co. of N. Am., Dec. 3, 2007) (Indexed annuities represent approximately two-thirds of gross premiums written.); American Equity Investment Life Holding Company (Annual Report on Form 10-K, at F-16 (Mar. 14, 2008)) (Indexed annuities accounted for approximately 97% of total purchase payments in 2007.); Americo Financial Life and Annuity Insurance Company (Best's Company Reports, Americo Fin. Life and Annuity Ins. Co., Jul. 10, 2007) (Indexed annuities represent over eighty percent of annuity premiums and almost half of annuity reserves.); Aviva USA Group (Best's Company Reports, AmerUs Life Insurance Company, Nov. 6, 2007) (Indexed annuity sales represent more than 90% of total annuity production.); Conseco Insurance Group (CIG) (Best's Company Reports, Conseco Ins. Group, Nov. 7, 2008) (CIG's business was heavily weighted toward indexed annuities, which contributed approximately 77% of new first year premiums.); Investors Insurance Corporation (IIC) (Best's Company Reports, Investors Ins. Corp., Aug. 20, 2007) (IIC's primary product has been indexed annuities.); Life Insurance Company of the Southwest ("LSW") (Best's Company Reports, Life Ins. Co. of the Southwest, Jun. 28, 2007) (LSW specializes in the

addition, in recent years, guarantees provided by indexed annuities have been reduced. In the years immediately following their introduction, indexed annuities typically guaranteed 90% of purchase payments accumulated at 3% annual interest.[19] More recently, however, following changes in state insurance laws,[20] guarantees in indexed annuities have been as low as 87.5% of purchase payments accumulated at 1% annual interest.[21]

At the same time that sales of indexed annuities have increased and guarantees within the products have been reduced, concerns about potentially abusive sales practices

---

sale of annuities, primarily indexed annuities.); Midland National Life Insurance Company (Best's Company Reports, Midland Nat'l Life Ins. Co., Jan. 24, 2008) (Sales of indexed annuities in recent years has been the principal driver of growth in annuity deposits.).

19 Securities Act Release No. 7438 (Aug. 20, 1997) [62 FR 45359, 45360 (Aug. 27, 1997)] (concept release requesting comments on structure of equity indexed insurance products, the manner in which they are marketed, and other matters the Commission should consider in addressing federal securities law issues raised by these products) ("1997 Concept Release"). See also Letter from American Academy of Actuaries (Jan. 5, 1998); Letter from Aid Association for Lutherans (Nov. 19, 1997) (comment letters in response to 1997 Concept Release). The comment letters on the 1997 Concept Release are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC (File No. S7-22-97). Some of the comment letters are also available on the Commission's Web site at http://www.sec.gov/rules/concept/s72297.shtml.

20 See, e.g., CAL. INS. CODE § 10168.25 (West 2007) (current requirements, providing for guarantee based on 87.5% of purchase payments accumulated at minimum of 1% annual interest); CAL. INS. CODE § 10168.2 (West 2003) (former requirements, providing for guarantee for single premium annuities based on 90% of premium accumulated at minimum of 3% annual interest).

21 See A Producer's Guide to Indexed Annuities 2006, LIFE INSURANCE SELLING (Jun. 2006), available at: http://www.lifeinsuranceselling.com/Media/MediaManager/6IAsurveyforweb3.pdf.

and inadequate disclosure have grown. In August 2005, NASD[22] issued a Notice to Members in which it cited its concerns about the manner in which persons associated with broker-dealers were marketing unregistered indexed annuities and the absence of adequate supervision of those sales practices.[23] The Notice to Members also expressed NASD's concern with indexed annuity sales materials that do not fully describe the features and risks of the products. Citing uncertainty as to whether indexed annuities are subject to the federal securities laws, NASD encouraged member firms to supervise transactions in these products as though they are securities.

At the Senior Summit held at the Commission in July 2006, at which securities regulators and others met to explore how to coordinate efforts to protect older Americans from abusive sales practices and securities fraud, concerns were cited about sales of indexed annuities to seniors.[24] Patricia Struck, then President of the North American Securities Administrators Association ("NASAA"), identified indexed annuities as among the most pervasive products involved in senior investment fraud.[25] In a joint

---

22 In July 2007, NASD and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange were consolidated to create FINRA. The NASD materials cited in this release were issued prior to the creation of FINRA.

23 NASD, Equity-Indexed Annuities, Notice to Members 05-50 (Aug. 2005), available at: http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p014821.pdf.

See also FINRA, supra note 4 (investor alert on indexed annuities, stating that indexed annuities are "anything but easy to understand").

24 The average age of issuance for indexed annuities has been reported to be 64. Advantage Compendium, 4th Quarter Index Annuity Sales Slip (Mar. 2008), available at: http://www.indexannuity.org/ic2008.htm#4q07.

25 Statement of Patricia Struck, President, NASAA, at the Senior Summit of the United States Securities and Exchange Commission, July 17, 2006, available at: http://www.nasaa.org/IssuesAnswers/Legislative Activity/Testimony/4999.cfm.

examination conducted by the Commission, NASAA, and the Financial Industry Regulatory Authority, Inc. ("FINRA") of "free lunch" seminars that are aimed at selling financial products, often to seniors, with a free meal as enticement, examiners identified potentially misleading sales materials and potential suitability issues relating to the products discussed at the seminars, which commonly included indexed annuities.[26]

C. Section 3(a)(8) Exemption

Section 3(a)(8) of the Securities Act provides an exemption for any "annuity contract" or "optional annuity contract" issued by a corporation that is subject to the supervision of the insurance commissioner, bank commissioner, or similar state regulatory authority.[27] The exemption, however, is not available to all contracts that are considered annuities under state insurance law. For example, variable annuities, which pass through to the purchaser the investment performance of a pool of assets, are not exempt annuity contracts.

The U.S. Supreme Court has addressed the insurance exemption on two occasions.[28] Under these cases, factors that are important to a determination of an

---

26 Office of Compliance Inspections and Examinations, Securities and Exchange Commission, et al., Protecting Senior Investors: Report of Examinations of Securities Firms Providing 'Free Lunch' Sales Seminars, at 4 (Sept. 2007), available at: http://www.sec.gov/spotlight/seniors/freelunchreport.pdf.

27 The Commission has previously stated its view that Congress intended any insurance contract falling within Section 3(a)(8) to be excluded from all provisions of the Securities Act notwithstanding the language of the Act indicating that Section 3(a)(8) is an exemption from the registration but not the antifraud provisions. Securities Act Release No. 6558 (Nov. 21, 1984) [49 FR 46750, 46753 (Nov. 28, 1984)]. See also Tcherepnin v. Knight, 389 U.S. 332, 342 n.30 (1967) (Congress specifically stated that "insurance policies are not to be regarded as securities subject to the provisions of the [Securities] act," (quoting H.R. Rep. 85, 73d Cong., 1st Sess. 15 (1933)).

28 VALIC, supra note 3, 359 U.S. 65; United Benefit, supra note 3, 387 U.S. 202.

annuity's status under Section 3(a)(8) include (1) the allocation of investment risk between insurer and purchaser, and (2) the manner in which the annuity is marketed.

With regard to investment risk, beginning with SEC v. Variable Annuity Life Ins. Co. ("VALIC"),[29] the Court has considered whether the risk is borne by the purchaser (tending to indicate that the product is not an exempt "annuity contract") or by the insurer (tending to indicate that the product falls within the Section 3(a)(8) exemption). In VALIC, the Court determined that variable annuities, under which payments varied with the performance of particular investments and which provided no guarantee of fixed income, were not entitled to the Section 3(a)(8) exemption. In SEC v. United Benefit Life Ins. Co. ("United Benefit"),[30] the Court extended the VALIC reasoning, finding that a contract that provides for some assumption of investment risk by the insurer may nonetheless not be entitled to the Section 3(a)(8) exemption. The United Benefit insurer guaranteed that the cash value of its variable annuity contract would never be less than 50% of purchase payments made and that, after ten years, the value would be no less than 100% of payments. The Court determined that this contract, under which the insurer did assume some investment risk through minimum guarantees, was not an "annuity contract" under the federal securities laws. In making this determination, the Court concluded that "the assumption of an investment risk cannot by itself create an insurance provision under the federal definition" and distinguished a "contract which to some degree is insured" from a "contract of insurance."[31]

---

29 VALIC, supra note 3, 359 U.S. at 71-73.

30 United Benefit, supra note 3, 387 U.S. at 211.

31 Id. at 211.

In analyzing investment risk, Justice Brennan's concurring opinion in VALIC applied a functional analysis to determine whether a new form of investment arrangement that emerges and is labeled "annuity" by its promoters is the sort of arrangement that Congress was willing to leave exclusively to the state insurance commissioners. In that inquiry, the purposes of the federal securities laws and state insurance laws are important. Justice Brennan noted, in particular, that the emphasis in the Securities Act is on disclosure and that the philosophy of the Act is that "full disclosure of the details of the enterprise in which the investor is to put his money should be made so that he can intelligently appraise the risks involved."[32] Where an investor's investment in an annuity is sufficiently protected by the insurer, state insurance law regulation of insurer solvency and the adequacy of reserves are relevant. Where the investor's investment is not sufficiently protected, the disclosure protections of the Securities Act assume importance.

Marketing is another significant factor in determining whether a state-regulated insurance contract is entitled to the Securities Act "annuity contract" exemption . In United Benefit, the U.S. Supreme Court, in holding an annuity to be outside the scope of Section 3(a)(8), found significant the fact that the contract was "considered to appeal to the purchaser not on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management."[33] Under these circumstances, the

---

32 VALIC, supra note 3, 359 U.S. at 77.

33 United Benefit, supra note 3, 387 U.S. at 211.

Court concluded "it is not inappropriate that promoters' offerings be judged as being what they were represented to be."[34]

In 1986, given the proliferation of annuity contracts commonly known as "guaranteed investment contracts," the Commission adopted rule 151 under the Securities Act to establish a "safe harbor" for certain annuity contracts that are not deemed subject to the federal securities laws and are entitled to rely on Section 3(a)(8) of the Securities Act.[35] Under rule 151, an annuity contract issued by a state-regulated insurance company is deemed to be within Section 3(a)(8) of the Securities Act if (1) the insurer assumes the investment risk under the contract in the manner prescribed in the rule; and (2) the contract is not marketed primarily as an investment.[36] Rule 151 essentially codifies the tests the courts have used to determine whether an annuity contract is entitled to the Section 3(a)(8) exemption, but adds greater specificity with respect to the investment risk test. Under rule 151, an insurer is deemed to assume the investment risk under an annuity contract if, among other things,

(1) the insurer, for the life of the contract,

---

34 Id. at 211 (quoting SEC v. Joiner Leasing Corp., 320 U.S. 344, 352-53 (1943)). For other cases applying a marketing test, see Berent v. Kemper Corp., 780 F. Supp. 431 (E.D. Mich. 1991), aff'd, 973 F. 2d 1291 (6th Cir. 1992); Associates in Adolescent Psychiatry v. Home Life Ins. Co., 729 F.Supp. 1162 (N.D. Ill. 1989), aff'd, 941 F.2d 561 (7th Cir. 1991); and Grainger v. State Security Life Ins. Co., 547 F.2d 303 (5th Cir. 1977).

35 17 CFR 230.151; Securities Act Release No. 6645 (May 29, 1986) [51 FR 20254 (June 4, 1986)]. A guaranteed investment contract is a deferred annuity contract under which the insurer pays interest on the purchaser's payments at a guaranteed rate for the term of the contract. In some cases, the insurer also pays discretionary interest in excess of the guaranteed rate.

36 17 CFR 230.151(a).

(a) guarantees the principal amount of purchase payments and credited interest, less any deduction for sales, administrative, or other expenses or charges; and

(b) credits a specified interest rate that is at least equal to the minimum rate required by applicable state law; and

(2) the insurer guarantees that the rate of any interest to be credited in excess of the guaranteed minimum rate described in paragraph 1(b) will not be modified more frequently than once per year.[37]

Indexed annuities are not entitled to rely on the safe harbor of rule 151 because they fail to satisfy the requirement that the insurer guarantee that the rate of any interest to be credited in excess of the guaranteed minimum rate will not be modified more frequently than once per year.[38]

---

[37] 17 CFR 230.151(b) and (c). In addition, the value of the contract may not vary according to the investment experience of a separate account.

[38] Some indexed annuities also may fail other aspects of the safe harbor test.

In adopting rule 151, the Commission declined to extend the safe harbor to excess interest rates that are computed pursuant to an indexing formula that is guaranteed for one year. Rather, the Commission determined that it would be appropriate to permit insurers to make limited use of index features, provided that the insurer specifies an index to which it would refer, no more often than annually, to determine the excess interest rate that it would guarantee for the next 12-month or longer period. For example, an insurer would meet this test if it established an "excess" interest rate of 5% by reference to the past performance of an external index and then guaranteed to pay 5% interest for the coming year. Securities Act Release No. 6645, supra note 35, 51 FR at 20260. The Commission specifically expressed concern that index feature contracts that adjust the rate of return actually credited on a more frequent basis operate less like a traditional annuity and more like a security and that they shift to the purchaser all of the investment risk regarding fluctuations in that rate.

The only judicial decision that we are aware of regarding the status of indexed annuities under the federal securities laws is a district court case that concluded that the contracts at issue in the case fell within the Commission's Rule 151 safe harbor notwithstanding the fact that they apparently did not meet the limited test described above, i.e., specifying an

III. DISCUSSION OF THE PROPOSED AMENDMENTS

The Commission has determined that providing greater clarity with regard to the status of indexed annuities under the federal securities laws would enhance investor protection, as well as provide greater certainty to the issuers and sellers of these products with respect to their obligations under the federal securities laws. We are proposing a new definition of "annuity contract" that, on a prospective basis, would define a class of indexed annuities that are outside the scope of Section 3(a)(8). With respect to these annuities, investors would be entitled to all the protections of the federal securities laws, including full and fair disclosure and sales practice protections. We are also proposing a new exemption under the Exchange Act that would apply to insurance companies that issue indexed annuities and certain other securities that are registered under the Securities Act and regulated as insurance under state law. We believe that this exemption is necessary or appropriate in the public interest and consistent with the protection of investors because of the presence of state oversight of insurance company financial condition and the absence of trading interest in these securities.

A. Definition of Annuity Contract

The Commission is proposing new rule 151A, which would define a class of indexed annuities that are not "annuity contracts" or "optional annuity contracts"[39] for

---

index that would be used to determine a rate that would remain in effect for at least one year. Instead, the contracts appear to have guaranteed the index-based formula, but not the actual rate of interest. See Malone v. Addison Ins. Marketing, Inc., 225 F.Supp.2d 743, 751-754 (W.D. Ky. 2002).

39 An "optional annuity contract" is a deferred annuity. See United Benefit, supra note 3, 387 U.S. at 204. In a deferred annuity, annuitization begins at a date in the future, after assets in the contract have accumulated over a period of time (normally many years). In contrast, in an immediate annuity, the insurer begins making annuity payments shortly

purposes of Section 3(a)(8) of the Securities Act. Although we recognize that these instruments are issued by insurance companies and are treated as annuities under state law, these facts are not conclusive for purposes of the analysis under the federal securities laws.

1. Analysis

"Insurance" and "Annuity": Federal Terms under the Federal Securities Laws

Our analysis begins with the well-settled conclusion that the terms "insurance" and "annuity contract" as used in the Securities Act are "federal terms," the meanings of which are a "federal question" under the federal securities laws.[40] The Securities Act does not provide a definition of either term, and we have not previously provided a definition that applies to indexed annuities.[41] Moreover, indexed annuities did not exist and were not contemplated by Congress when it enacted the insurance exemption.

We therefore analyze indexed annuities under the facts and circumstances factors articulated by the U.S. Supreme Court in VALIC and United Benefit. In particular, we focus on whether these instruments are "the sort of investment form that Congress was

---

after the purchase payment is made; i.e., within one year. See Kenneth Black, Jr., and Harold D. Skipper, Jr., Life and Health Insurance, at 164 (2000).

40 See VALIC, supra note 3, 359 U.S. at 69.

41 The last time the Commission formally addressed indexed annuities was in 1997. At that time, the Commission issued a concept release requesting public comment regarding indexed insurance contracts. The concept release stated that "depending on the mix of features . . . [an indexed insurance contract] may or may not be entitled to exemption from registration under the Securities Act" and that the Commission was "considering the status of [indexed annuities and other indexed insurance contracts] under the federal securities laws." See Concept Release, supra note 19, at 4-5.

The Commission has previously adopted a safe harbor for certain annuity contracts that are entitled to rely on Section 3(a)(8) of the Securities Act. However, as discussed in Part II.C., indexed annuities are not entitled to rely on the safe harbor.

. . . willing to leave exclusively to the State Insurance Commissioners" and whether they necessitate the "regulatory and protective purposes" of the Securities Act.[42]

Type of Investment

We believe that the indexed annuities that would be included in our proposed definition are not the sort of investment that Congress contemplated leaving exclusively to state insurance regulation. According to the U.S. Supreme Court, Congress intended to include in the insurance exemption only those policies and contracts that include a "true underwriting of risks" and "investment risk-taking" by the insurer.[43] Moreover, the level of risk assumption necessary for a contract to be "insurance" under the Securities Act must be meaningful – the assumption of an investment risk does not "by itself create an insurance provision under the federal definition."[44]

The annuities that "traditionally and customarily" were offered at the time Congress enacted the insurance exemption were fixed annuities that typically involved no investment risk to the purchaser.[45] These contracts offered the purchaser "specified and definite amounts beginning with a certain year of his or her life," and the "standards for

---

42 See VALIC, supra note 3, 359 U.S. at 75 (Brennan, J., concurring) (". . . if a brand-new form of investment arrangement emerges which is labeled 'insurance' or 'annuity' by its promoters, the functional distinction that Congress set up in 1933 and 1940 must be examined to test whether the contract falls within the sort of investment form that Congress was then willing to leave exclusively to the State Insurance Commissioners. In that inquiry, an analysis of the regulatory and protective purposes of the Federal Acts and of state insurance regulation as it then existed becomes relevant.").

43 Id. at 71-73.

44 See United Benefit, supra note 3, 387 U.S. at 211 ("[T]he assumption of investment risk cannot by itself create an insurance provision. . . . The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized.").

45 See VALIC, supra note 3, 359 U.S. at 69.

investments of funds" by the insurer under these contracts were "conservative."[46] Moreover, these types of annuity contracts were part of a "concept which had taken on its coloration and meaning largely from state law, from state practice, from state usage."[47] Thus, Congress exempted these instruments from the requirements of the federal securities laws because they were a "form of 'investment'. . . which did not present very squarely the problems that [the federal securities laws] were devised to deal with," and were "subject to a form of state regulation of a sort which made the federal regulation even less relevant."[48]

In contrast, when the amounts payable by an insurer under an indexed annuity contract are more likely than not to exceed the amounts guaranteed under the contract, the purchaser assumes substantially different risks and benefits. 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.

By purchasing this type of indexed annuity, the purchaser assumes the risk of an uncertain and fluctuating financial instrument, in exchange for exposure to future, securities-linked returns. The value of such an indexed annuity reflects the benefits and risks inherent in the securities market, and the contract's value depends upon the

---

46 Id. ("While all the States regulate 'annuities' under their 'insurance' laws, traditionally and customarily they have been fixed annuities, offering the annuitant specified and definite amounts beginning with a certain year of his or her life. The standards for investment of funds underlying these annuities have been conservative.").

47 Id. ("Congress was legislating concerning a concept which had taken on its coloration and meaning largely from state law, from state practice, from state usage.").

48 Id. at 75 (Brennan, J., concurring).

trajectory of that same market. Thus, the purchaser obtains an instrument that, by its very terms, depends on market volatility and risk.

Such indexed annuity contracts provide some protection against the risk of loss, but these provisions do not, "by [themselves,] create an insurance provision under the federal definition."[49] Rather, these provisions reduce – but do not eliminate – a purchaser's exposure to investment risk under the contract. These contracts may to some degree be insured, but that degree may be too small to make the indexed annuity a contract of insurance.[50]

Thus, the 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. Purchasers of these annuities assume the investment risk for investments that are more likely than not to fluctuate and move with the securities markets. The value of the purchaser's investment is more likely than not to depend on movements in the underlying securities index. 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.[51]

---

49 See United Benefit, supra note 3, 387 U.S. at 211 (finding that while a "guarantee of cash value" provided by an insurer to purchasers of a deferred annuity plan reduced "substantially the investment risk of the contract holder, the assumption of investment risk cannot by itself create an insurance provision under the federal definition.").

50 Id. at 211 ("The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized.").

51 See VALIC, supra note 3, 359 U.S. at 71 (finding that although the insurer's assumption of a traditional insurance risk gives variable annuities an "aspect of insurance," this is "apparent, not real; superficial, not substantial.").

Need for the Regulatory Protections of the Federal Securities Acts

We also analyze indexed annuities to determine whether they implicate the regulatory and protective purposes of the federal securities laws. Based on that analysis, we believe that the indexed annuities that would be included in our proposed definition present many of the concerns that Congress intended the federal securities laws to address.

Indexed annuities are similar in many ways to mutual funds, variable annuities, and other securities. Although these contracts contain certain features that are typical of insurance contracts,[52] they also may contain "to a very substantial degree elements of investment contracts."[53] Indexed annuities are attractive to purchasers precisely because they offer participation in the securities markets. Thus, individuals who purchase such indexed annuities are "vitally interested in the investment experience."[54] However, indexed annuities historically have not been registered with us as securities. Insurers have treated these annuities as subject only to state insurance laws.

There is a strong federal interest in providing investors with disclosure, antifraud, and sales practice protections when they are purchasing annuities that are likely to expose them to market volatility and risk. We believe that individuals who purchase indexed

---

52 The presence of protection against loss does not, in itself, transform a security into an insurance or annuity contract. Like indexed annuities, variable annuities typically provide some protection against the risk of loss, but are registered as securities. Historically, variable annuity contracts have typically provided a minimum death benefit at least equal to the greater of contract value or purchase payments less any withdrawals. More recently, many contracts have offered benefits that protect against downside market risk during the purchaser's lifetime.

53 Id. at 91 (Brennan, J., concurring).

54 Id. at 89 (Brennan, J., concurring).

annuities that are more likely than not to provide payments that vary with the performance of securities are exposed to significant investment risks. They are confronted with many of the same risks and benefits that other securities investors are confronted with when making investment decisions. Moreover, they are more likely than not to experience market volatility.

Accordingly, we believe that the regulatory objectives that Congress was attempting to achieve when it enacted the Securities Act are present when the amounts payable by an insurer under an indexed annuity contract are more likely than not to exceed the guaranteed amounts. Therefore, we are proposing a rule that would define such contracts as falling outside the insurance exemption.

2. Proposed Definition

Scope of the Proposed Definition

Proposed rule 151A would apply to a contract that is issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.[55] This language is the same language used in Section 3(a)(8) of the Securities Act. Thus, the insurance companies that will be covered by the proposed rule are the same as those covered by Section 3(a)(8). In addition, in order to be covered by the proposed rule, a contract must be subject to regulation as an annuity under state insurance law.[56] As a result, the proposed rule does not apply to contracts that

---

55 Proposed rule 151A(a).

56 Id. We note that the majority of states include in their insurance laws provisions that define annuities. See, e.g., ALA. CODE § 27-5-3 (2008); CAL. INS. CODE § 1003 (West 2007); N.J. ADMIN. CODE tit. 11, § 4-2.2 (2008); N.Y. INS. LAW § 1113 (McKinney

are regulated under state insurance law as life insurance, health insurance, or any form of insurance other than an annuity, and it does not apply to any contract issued by an insurance company if the contract itself is not subject to regulation under state insurance law.

The proposed rule would expressly state that it does not apply to any contract whose value varies according to the investment experience of a separate account.[57] The effect of this provision is to eliminate variable annuities from the scope of the rule.[58] It has long been established that variable annuities are not entitled to the exemption under Section 3(a)(8) of the Securities Act, and, accordingly, we do not propose to cover them under the new definition or affect their regulation in any way.[59]

We request comment on the scope of the proposed definition and in particular on the following issues:

- Should the rule apply only to contracts that are issued by the same insurance companies that are covered by Section 3(a)(8) of the Securities Act, or should

---

2007). Those states that do not expressly define annuities typically have regulations in place that address annuities. See, e.g., KAN. ADMIN. REGS. § 40-2-12 (2008); MISS. CODE ANN. § 83-1-151 (2008).

57 Proposed rule 151A(c).

58 The assets of a variable annuity are held in a separate account of the insurance company that is insulated for the benefit of the variable annuity owners from the liabilities of the insurance company, and amounts paid to the owner under a variable annuity vary according to the investment experience of the separate account. See Black and Skipper, supra note 39, at 174-77 (2000).

59 See, e.g., VALIC, supra note 3, 359 U.S. 65; United Benefit, supra note 3, 387 U.S. 202. In addition, an insurance company separate account issuing variable annuities is an investment company under the Investment Company Act of 1940. See Prudential Ins. Co. of Am. v. SEC, 326 F.2d 383 (3d Cir. 1964).

the proposed definition apply with respect to contracts of different issuers than those covered by Section 3(a)(8)?

- What contracts should be covered by the proposed definition? Should the scope of contracts covered be articulated by reference to state law? Should the proposed definition extend to all annuity contracts, or should any annuity contracts be excluded? Should variable annuity contracts be covered by the proposed definition? Should the proposed definition apply to forms of insurance other than annuities, such as life insurance or health insurance? Should the proposed definition apply to a contract issued by an insurance company if the contract is not itself regulated as insurance under state law?
- Should we permit insurance companies to register indexed annuities, as well as any other annuities that are securities, on Form N-4,[60] the form that is currently used by insurance companies to register variable annuities under the Securities Act? If so, should we modify Form N-4, which is also used by insurance company separate accounts to register under the Investment Company Act, in any way?

Definition of "Annuity Contract" and "Optional Annuity Contract"

We are proposing that an annuity issued by an insurance company would not be an "annuity contract" or an "optional annuity contract" under Section 3(a)(8) of the Securities Act if the annuity has the following two characteristics. First, amounts payable by the insurance company under the contract are calculated, in whole or in part, by reference to the performance of a security, including a group or index of securities.

[60] 17 CFR 239.17b and 274.11c.

Second, amounts payable by the insurance company under the contract are more likely than not to exceed the amounts guaranteed under the contract.

The first characteristic, that amounts payable by the insurance company under the contract are calculated by reference to the performance of a security or securities, defines a class of contracts that we believe, in all cases, require further scrutiny because they implicate the factors articulated by the U.S. Supreme Court as important in determining whether the Section 3(a)(8) exemption is applicable. When payments under a contract are calculated by reference to the performance of a security or securities, rather than being paid in a fixed amount, at least some investment risk relating to the performance of the securities is assumed by the purchaser. In addition, the contract may be marketed on the basis of the potential for growth offered by investments in the securities.

The proposed rule would define the class of contracts that is subject to scrutiny broadly. The rule would apply whenever any amounts payable under the contract under any circumstances, including full or partial surrender, annuitization, or death, are calculated, in whole or in part, by reference to the performance of a security or securities. If, for example, the amount payable under a contract upon a full surrender is not calculated by reference to the performance of a security or securities, but the amount payable upon annuitization is so calculated, then the contract would need to be analyzed under the rule. As another example, if amounts payable under a contract are partly fixed in amount and partly dependent on the performance of a security or securities, the contract would need to be analyzed under the rule.

We note that the proposed rule would apply to contracts under which amounts payable are calculated by reference to a security, including a group or index of securities.

Thus, the proposed rule would, by its terms, apply to indexed annuities but also to other annuities where amounts payable are calculated by reference to a single security or any group of securities. The federal securities laws, and investors' interests in full and fair disclosure and protection from abusive sales practices, are equally implicated, whether amounts payable under an annuity are calculated by reference to a securities index, another group of securities, or a single security.

The term "security" in proposed rule 151A would have the same broad meaning as in Section 2(a)(1) of the Securities Act. Proposed rule 151A does not define the term "security," and our existing rules provide that, unless otherwise specifically provided, the terms used in the rules and regulations under the Securities Act have the same meanings defined in the Act.[61]

The second characteristic, that amounts payable by the insurance company under the contract are more likely than not to exceed the amounts guaranteed under the contract, sets forth the test that would define a class of contracts that are not "annuity contracts" or "optional annuity contracts" under the Securities Act and that, therefore, are not entitled to the Section 3(a)(8) exemption. As explained above, by purchasing this type of indexed annuity, the purchaser assumes the risk of an uncertain and fluctuating financial instrument, in exchange for exposure to future, securities-linked returns.[62] As a result, the purchaser assumes many of the same risks that investors assume when investing in mutual funds, variable annuities, and other securities. Our proposal is intended to provide the purchaser of such an annuity with the same protections that are

---

61 17 CFR 230.100(b).

62 See supra Part III.A.1.

provided under the federal securities laws to other investors who participate in the securities markets, including full and fair disclosure regarding the terms of the investment and the significant risks that he or she is assuming, as well as protection from abusive sales practices and the recommendation of unsuitable transactions.

Under proposed rule 151A, amounts payable by the insurance company under a contract would be more likely than not to exceed the amounts guaranteed under the contract if this were the expected outcome more than half the time. In order to determine whether this is the case, it would be necessary to analyze expected outcomes under various scenarios involving different facts and circumstances. In performing this analysis, the amounts payable by the insurance company under any particular set of facts and circumstances would be the amounts that the purchaser[63] would be entitled to receive from the insurer under those facts and circumstances. The facts and circumstances would include, among other things, the particular features of the annuity contract (e.g., in the case of an indexed annuity, the relevant index, participation rate, and other features), the particular options selected by the purchaser (e.g., surrender or annuitization), and the performance of the relevant securities benchmark (e.g., in the case of an indexed annuity, the performance of the relevant index, such as the Dow Jones Industrial Average, Lehman Brothers Aggregate U.S. Index, Nasdaq 100 Index, or Standard & Poor's 500 Composite Stock Price Index). The amounts guaranteed under a contract under any particular set of facts and circumstances would be the minimum amount that the insurer

[63] For simplicity, we are referring to payments to the purchaser. The proposed rule, however, references payments by the insurer without reference to a specified payee. In performing the analysis, payments to any payee, including the purchaser, annuitant, and beneficiaries would be included.

would be obligated to pay the purchaser under those facts and circumstances without reference to the performance of the security that is used in calculating amounts payable under the contract. Thus, if an indexed annuity, in all circumstances, were to guarantee that, on surrender, a purchaser would receive 87.5% of purchase payments, plus 1% interest compounded annually, and that any additional payout would be based exclusively on the performance of a securities index, the amount guaranteed after 3 years would be 90.15% of purchase payments (87.5% x 1.01 x 1.01 x 1.01).

We request comment on the proposed definition and in particular on the following issues:

- Should we define a class of annuities that are not "annuity contracts" or "optional annuity contracts" under the Securities Act? If so, should we adopt the proposed definition or should the proposed definition be modified?
- Should we provide greater clarity with respect to the status under the Securities Act of annuities under which amounts payable by the insurance company are calculated, in whole or in part, by reference to the performance of a security, including a group or index of securities? Should we, as proposed, adopt a definitional rule that would apply to all such annuities? Or should we adopt a definitional rule that applies to a more limited subset of annuities, such as annuities under which amounts payable are calculated by reference to the performance of a securities index?
- Is the proposed test that defines a class of contracts that are not "annuity contracts" or "optional annuity contracts," i.e., that amounts payable by the insurance company under the contract are more likely than not to exceed the

amounts guaranteed under the contract, an appropriate test? Should the test be modified in any way, e.g., should the threshold be higher or lower than "more likely than not?" Should we provide further clarification with respect to the meaning of any of the elements of that test, including "amounts payable by the insurance company under the contract" and "amounts guaranteed under the contract?"

- Should we specify a particular point in time as of which "amounts payable by the insurance company under the contract" and "amounts guaranteed under the contract" should be determined under the rule? If so, what would be an appropriate time, e.g., contract maturity, the point where the surrender charge period ends, a specified number of years (5 years, 10 years, 15 years, 20 years, or some other period), or a specified age of the annuitant or a joint annuitant under the contract (60 years, 65 years, 75 years, or some other age)?

Determining Whether an Annuity Is not an "Annuity Contract" or "Optional Annuity Contract" under Proposed Rule 151A

Proposed rule 151A addresses the manner in which a determination would be made regarding whether amounts payable by the insurance company under a contract are more likely than not to exceed the amounts guaranteed under the contract. The proposed rule is principles-based, providing that a determination made by the insurer at or prior to issuance of a contract would be conclusive, provided that: (i) both the insurer's methodology and the insurer's economic, actuarial, and other assumptions are reasonable; (ii) the insurer's computations are materially accurate; and (iii) the determination is made not earlier that six months prior to the date on which the form of contract is first offered and not more than three years prior to the date on which the particular contract is issued.[64] The proposed rule would, however, specify the treatment of charges that are imposed at the time of payments under the contract by the insurer.[65]

We are proposing this principles-based approach because we believe that an insurance company should be able to evaluate anticipated outcomes under an annuity that it issues. Insurers routinely undertake such analyses for purposes of pricing and hedging their contracts.[66] In addition, we believe that it is important to provide reasonable certainty to insurers with respect to the application of the proposed rule and to preclude an insurer's determination from being second guessed, in litigation or otherwise, in light of actual events that may differ from assumptions that were reasonable when made.

As with all exemptions from the registration and prospectus delivery requirements of the Securities Act, the party claiming the benefit of the exemption – in this case, the insurer – bears the burden of proving that the exemption applies.[67] Thus, an insurer that believes an indexed annuity is entitled to the exemption under Section 3(a)(8) based, in part, on a determination made under the proposed rule would – if challenged in litigation – be required to prove that its methodology and its economic, actuarial, and other assumptions were reasonable, and that the computations were materially accurate.

The proposed rule provides that an insurer's determination under the rule would be conclusive only if it is made at or prior to issuance of the contract. Proposed rule

---

64 Proposed rule 151A(b)(2).

65 Proposed rule 151A(b)(1).

66 See generally, Black and Skipper, supra note 39, at 26-47, 890-99.

67 See, e.g., SEC v. Ralston Purina, 346 U.S. 119, 126 (1953) (an issuer claiming an exemption under Section 4 of the Securities Act carries the burden of showing that the exemption applies).

151A is intended to provide certainty to both insurers and investors, and we believe that this certainty would be undermined unless insurance companies undertake the analysis required by the rule no later than the time that an annuity is issued. The proposed rule also provides that, for an insurer's determination to be conclusive, the computations made by the insurance company in support of the determination must be materially accurate. An insurer should not be permitted to rely on a determination of an annuity's status under the proposed rule that is based on computations that are materially inaccurate. For this purpose, we intend that computations would be considered to be materially accurate if any computational errors do not affect the outcome of the insurer's determination as to whether amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract.

In order for an insurer's determination to be conclusive, both the methodology and the economic, actuarial, and other assumptions used would be required to be reasonable. We recognize that a range of methodologies and assumptions may be reasonable and that a reasonable methodology or assumption utilized by one insurer may differ from a reasonable assumption or methodology selected by another insurer. In determining whether an insurer's methodology is reasonable, it would be appropriate to look to methods commonly used for valuing and hedging similar products in insurance and derivatives markets.

An insurer will need to make assumptions in several areas, including assumptions about (i) insurer behavior, (ii) purchaser behavior, and (iii) market behavior, and will need to assign probabilities to various potential behaviors. With regard to insurer behavior, the insurer will need to make assumptions about discretionary actions that it may take under the terms of an annuity. In the case of an indexed annuity, for example, an insurer often has discretion to modify various features, such as guaranteed interest rates, caps, participation rates, and spreads. Similarly, the insurer will need to make assumptions concerning purchaser behavior, including matters such as how long purchasers will hold a contract, how they will allocate contract value among different investment options available under the contract, and the form in which they will take payments under the contract. Assumptions about market behavior would include assumptions about expected return, market volatility, and interest rates. In general, insurers will need to make assumptions about any feature of insurer, purchaser, or market behavior, or any other factor, that is material in determining the likelihood that amounts payable under the contract exceed the amounts guaranteed.

In determining whether assumptions are reasonable, insurers should generally be guided by both history and their own expectations about the future. An insurer may look to its own, and to industry, experience with similar or otherwise comparable contracts in constructing assumptions about both insurer behavior and investor behavior. In making assumptions about future market behavior, an insurer may be guided, for example, by historical market characteristics, such as historical returns and volatility, provided that the insurer bases its assumptions on an appropriate period of time and does not have reason to believe that the time period chosen is likely to be unrepresentative. As a general matter, assumptions about insurer, investor, or market behavior that are not consistent with historical experience would not be reasonable unless an insurer has a reasonable basis for any differences between historical experience and the assumptions used.

In addition, an insurer may look to its own expectations about the future in constructing reasonable assumptions. As noted above, insurers routinely analyze anticipated outcomes for purposes of pricing and hedging their contracts, and for similar purposes. We would expect that, in making a determination under proposed rule 151A, an insurer would use assumptions that are consistent with the assumptions that it uses for other purposes. Generally, assumptions that are inconsistent with the assumptions that an insurer uses for other purposes would not be reasonable under proposed rule 151A.

We note that an insurer may offer a particular form of contract over a significant period of time. Assumptions that are reasonable when a contract is originally offered may or may not continue to be reasonable at a subsequent time when the insurer continues to offer the contract. For this reason, the rule would provide that an insurer's determination would be conclusive if it is sufficiently current. Specifically, the determination must be made not more than six months prior to the date on which the form of contract is first offered and not more than three years prior to the date on which a particular contract is issued. For example, if a form of contract were first offered on January 1, 2011, the insurer would be required to make the determination not earlier than July 1, 2010. If the same form of contract were issued to a particular individual on January 1, 2014, the insurer's determination would be required to be made not earlier than January 1, 2011, in order to be conclusive for this transaction. This approach is intended to address the changing nature of reasonable assumptions, while permitting an insurer to rely on its determination for a significant period of time (three years) once made.

Proposed rule 151A would require that, in determining whether amounts payable by the insurance company under the contract are more likely than not to exceed the amounts guaranteed under the contract, amounts payable under the contract be determined without reference to any charges that are imposed at the time of payment. For example, the calculation of amounts payable upon surrender would be computed without deduction of any surrender charges, which typically decline over time. We are proposing this calculation methodology in order to eliminate the differential impact that such charges would have on the determination depending on the assumptions made about contract holding periods. However, the proposed rule would require that charges imposed at the time of payment be reflected in computing the amounts guaranteed under the contract. In many cases, amounts guaranteed under annuities are not affected by charges imposed at the time payments are made by the insurer under the contract.[68] However, in the case of an annuity where the amounts guaranteed are affected by charges imposed at the time payments are made,[69] the determination under proposed rule 151A would be made using the actual amounts guaranteed under the contract (which reflect the impact of these charges).

---

68 Guaranteed minimum value, as commonly defined in indexed annuity contracts, equals a percentage of purchase payments, accumulated at a specified interest rate, as explained above, and this amount is not subject to surrender charges.

69 For example, a purchaser buys a contract for $100,000. The contract defines surrender value as the greater of (i) purchase payments plus index-linked interest minus surrender charges or (ii) the guaranteed minimum value. The maximum surrender charge is equal to 10%. The guaranteed minimum value is defined in the contract as 87.5% of premium accumulated at 1% annual interest. If the purchaser surrenders within the first year of purchase, and there is no index-linked interest credited, the surrender value would equal $90,000 (determined under clause (i) as $100,000 purchase payment minus 10% surrender charge), and this amount would be the guaranteed amount under the contract, not the lower amount defined in the contract as guaranteed minimum value ($87,500).

We request comment on the manner in which a determination would be made under proposed rule 151A regarding whether amounts payable by the insurance company under a contract are more likely than not to exceed the amounts guaranteed under the contract and, in particular, on the following issues:

- Should we, as proposed, adopt a principles-based approach to this determination? Would the principles-based approach facilitate our goal of providing certainty?
- Should the insurer's determination be conclusive? If so, are the conditions in the proposed rule (i.e., determination at or prior to contract issuance, reasonable methodology and assumptions, materially accurate computation) appropriate, or should we modify these conditions in any way?
- Should we expressly specify the circumstances under which a computation is materially accurate? If so, should the rule, as proposed, provide that an insurer's computation is materially accurate if any computational errors do not affect the outcome of the insurer's determination as to whether amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract? Or should we provide a different guideline for determining whether the computation is "materially accurate?" For example, should the rule provide that an insurer's computation is materially accurate if any computational errors do not materially affect the insurer's determination of the likelihood that amounts payable by the insurer under the contract exceed the amounts guaranteed under the contract?

- Should the rule prescribe the assumptions to be used by an insurer in making its determination? What factors should affect a determination of whether an insurer's assumptions are reasonable? Should the rule specify how the determination should be made with respect to securities, including indices, that have little or no history?
- Should we, as proposed, provide that, in order for an insurer's determination to be conclusive, it must be made not more than six months prior to the date on which the form of contract is first offered? Should this period be shorter or longer, e.g., 30 days, 3 months, 9 months, 1 year?
- Should we, as proposed, provide that, in order for an insurer's determination to be conclusive, it must not be made more than three years prior to the date on which a particular contract is issued? Should this period be shorter or longer, e.g., 1 year, 2 years, or 5 years?
- Should an insurer's determination, once made for a particular form of contract, be conclusive with respect to every particular contract of that form that is sold provided that the determination meets the standards required for conclusiveness at the time of the insurer's original determination, i.e., reasonable methodology and assumptions and materially accurate computation? Or should an insurer's determination only be conclusive with respect to any particular sale of a contract if the methodology and assumptions are reasonable at the time of the particular sale?
- How should surrender charges and other charges imposed at the time of payout under an annuity be treated in making the determination required under the

proposed rule? Should amounts payable under the contract be determined with or without reference to such charges? Should amounts guaranteed under the contract be computed with or without reference to such charges? Should we define with greater specificity the concept of charges imposed at the time of payment under a contract?

- Should we provide any guidance with respect to the principles-based approach of the rule?
- Should we provide guidance on the circumstances under which it is reasonable to rely on historical experience? Would it be reasonable to use other asset prices (such as derivative prices) to form expectations about the future, as long as the use of these prices is supported by historical experience?
- Should we provide guidance about the circumstances under which it is reasonable to rely on insurer expectations about the future? Would it be reasonable to rely on these expectations for factors over which insurers have control (e.g., changes in contract features) or about which they have particular expertise (e.g., rates of annuitization, mortality rates)? Would it be reasonable to rely on these expectations for factors over which insurers do not have control, such as market behavior?
- Should we provide guidance that would specify how insurers should consider interactions between various factors that may affect the determination (such as interactions between market returns and surrender behavior)?
- Should the rule specify how the determination should be made in the case of contracts that offer more than one investment option, e.g., multiple indices or

multiple crediting formulas or the availability of a guaranteed interest rate option in addition to indexed investment options? In such a case, should we require a separate determination under each available option? If so, should we provide that the entire annuity is not an "annuity contract" or "optional annuity contract" if it is determined that the annuity would not be an "annuity contract" or "optional annuity contract" under any one or more of the available options?

- Should the rule require separate determinations with respect to the various benefits available under an annuity, such as lump sum payments, annuity payments, and death benefits? If so, should the rule prescribe that if the amounts payable under any one of these options are more likely than not to exceed the amounts guaranteed under that option, then the entire contract is not an "annuity contract" or "optional contract?"

3. Effective Date

We propose to have the new definition apply prospectively – that is, only to indexed annuities issued on or after the effective date of a final rule. We are using our definitional rulemaking authority under Section 19(a) of the Securities Act, and the explicitly prospective nature of our proposed rule is consistent with similar prospective rulemaking that we have undertaken in the past when doing so was appropriate and fair under the circumstances.[70]

---

[70] See, e.g., Securities Act Release No. 4896 (Feb. 1, 1968) [33 FR 3142, 3143 (Feb. 17, 1968)] ("The Commission is aware that for many years issuers of the securities identified in this rule have not considered their obligations to be separate securities and that they have acted in reliance on the view, which they believed to be the view of the Commission, that registration under the Securities Act was not required. Under the circumstances, the Commission does not believe that such issuers are subject to any penalty or other damages resulting from entering into such arrangements in the past.

We are aware that many insurance companies, in the absence of definitive interpretation or definition by the Commission, have of necessity acted in reliance on their own analysis of the legal status of indexed annuities based on the state of the law prior to this release. Under these circumstances, we do not believe that insurance companies should be subject to any additional legal risk relating to their past offers and sales of indexed annuity contracts as a result of our proposal or its eventual adoption.

We also recognize that, if our proposal is adopted, the industry will need sufficient time to conduct the analysis required by the new definitional rule and comply with any applicable requirements under the federal securities laws. Therefore, we propose that if we adopt a final rule, the effective date of that rule would be a date that is 12 months after publication in the Federal Register.

We request comment on the proposed effective date of the rule and in particular on the following issue:

- Should the effective date of the new definitional rule, if adopted, be 12 months after publication in the Federal Register, or should it be effective sooner (e.g., 60 days after publication, six months after publication) or later (e.g, 18 months after publication, 2 years after publication)?

Paragraph (b) provides that the rule shall apply to transactions of the character described in paragraph (a) only with respect to bonds or other evidence of indebtedness issued after adoption of the rule."). See also Securities Act Release No. 5316 (Oct. 6, 1972) [37 FR 23631, 23632 (Nov. 7, 1972)] ("The Commission recognizes that the 'no-sale' concept has been in existence in one form or another for a long period of time. . . . The Commission believes, after a thorough reexamination of the studies and proposals cited above, that the interpretation embodied in Rule 133 is no longer consistent with the statutory objectives of the [Securities] Act. . . . Rule 133 is rescinded prospectively on and after January 1, 1973 . . . .").

4. Annuities not Covered by the Proposed Definition

Proposed rule 151A would apply to annuities under which amounts payable by the insurance company are calculated by reference to the performance of a security. The proposed rule would define certain of those annuities (annuities under which amounts payable by the issuer are more likely than not to exceed the amounts guaranteed under the contract) as not "annuity contracts" or "optional annuity contracts" under Section 3(a)(8) of the Securities Act. The proposed rule, however, would not provide a safe harbor under Section 3(a)(8) for any other annuities, including any other annuities under which amounts payable by the insurance company are calculated by reference to the performance of a security. The status under the Securities Act of any annuity, other than an annuity that is determined under proposed rule 151A to be not an "annuity contract" or "optional annuity contract," would continue to be determined by reference to the investment risk and marketing tests articulated in existing case law under Section 3(a)(8) and, to the extent applicable, the Commission's safe harbor rule 151.[71]

<u>We request comment on the proposal not to include a safe harbor in the proposal and in particular on the following issues</u>:

- Should we provide a safe harbor under Section 3(a)(8) of the Securities Act for any annuities under which amounts payable by the insurance company are calculated by reference to the performance of a security? If so, what should the safe harbor be?

---

71 As noted in Part II.C., above, indexed annuities are not entitled to rely on the rule 151 safe harbor.

- Should we modify the Commission's existing safe harbor for certain annuities, rule 151, to address indexed annuities or other annuities under which amounts payable by the insurance company are calculated by reference to the performance of a security? If so, how?

B. Exchange Act Exemption for Securities that Are Regulated as Insurance

The Commission is also proposing new rule 12h-7, which would provide an insurance company with an exemption from Exchange Act reporting with respect to indexed annuities and certain other securities issued by the company that are registered under the Securities Act and regulated as insurance under state law.[72] We are proposing this exemption because we believe that the exemption is necessary or appropriate in the public interest and consistent with the protection of investors. We base that view on two factors: first, the nature and extent of the activities of insurance company issuers, and their income and assets, and, in particular, the regulation of those activities and assets under state insurance law; and, second, the absence of trading interest in the securities.[73] We are also proposing to impose conditions to the exemption that relate to these factors

---

72 The Commission has received a petition requesting that we propose a rule that would exempt issuers of certain types of insurance contracts from Exchange Act reporting requirements. Letter from Stephen E. Roth, Sutherland Asbill & Brennan LLP, on behalf of Jackson National Life Insurance Co., to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission (Dec. 19, 2007) (File No. 4-553) available at: http://www.sec.gov/rules/petitions/2007/petn4-553.pdf.

73 See Section 12(h) of the Exchange Act [15 U.S.C. 78l(h)] (Commission may, by rules, exempt any class of issuers from the reporting provisions of the Exchange Act "if the Commission finds, by reason of the number of public investors, amount of trading interest in the securities, the nature and extent of the activities of the issuer, income or assets of the issuer, or otherwise, that such action is not inconsistent with the public interest or the protection of investors.") (emphasis added).

and that we believe are necessary or appropriate in the public interest and consistent with the protection of investors.

State insurance regulation is focused on insurance company solvency and the adequacy of insurers' reserves, with the ultimate purpose of ensuring that insurance companies are financially secure enough to meet their contractual obligations.[74] State insurance regulators require insurance companies to maintain certain levels of capital, surplus, and risk-based capital; restrict the investments in insurers' general accounts; limit the amount of risk that may be assumed by insurers; and impose requirements with regard to valuation of insurers' investments.[75] Insurance companies are required to file annual reports on their financial condition with state insurance regulators. In addition, insurance companies are subject to periodic examination of their financial condition by state insurance regulators. State insurance regulators also preside over the conservation or liquidation of companies with inadequate solvency.[76]

State insurance regulation, like Exchange Act reporting, relates to an entity's financial condition. We are of the view that, as a general matter, it may be unnecessary for both to apply in the same situation, which may result in duplicative regulation that is burdensome. Through Exchange Act reporting, issuers periodically disclose their financial condition, which enables investors and the markets to independently evaluate an issuer's income, assets, and balance sheet. State insurance regulation takes a different approach to the issue of financial condition, instead relying on state insurance regulators

---

74 Black and Skipper, supra note 39, at 949.

75 Id. at 949 and 956-59.

76 Id. at 949.

to supervise insurers' financial condition, with the goal that insurance companies be financially able to meet their contractual obligations. We believe that it would be consistent with our federal system of regulation, which has allocated the responsibility for oversight of insurers' solvency to state insurance regulators, to exempt insurers from Exchange Act reporting with respect to state-regulated insurance contracts.

Our conclusion in this regard is strengthened by the general absence of trading interest in insurance contracts. Insurance is typically purchased directly from an insurance company. While insurance contracts may be assigned in limited circumstances,[77] they typically are not listed or traded on securities exchanges or in other markets. As a result, outside the context of publicly owned insurance companies, there is little, if any, market interest in the information that is required to be disclosed in Exchange Act reports.

<u>We request comment on whether we should provide insurance companies with exemptions from Exchange Act reporting with respect to securities that are regulated as insurance under state law and in particular on the following issues</u>:

- Does the existence of state insurance regulation, and, in particular, state regulation of insurance company financial condition and solvency, support providing an exemption from Exchange Act reporting? Does Exchange Act reporting serve any purpose, in the context of insurance contracts that are also securities, that is not served by state insurance regulation?

---

77 Insurance contracts may be assigned either as a complete assignment or as collateral. Insurance contracts that are assignable typically provide that the insurer need not recognize the assignment until it receives written notice. <u>See</u> Black and Skipper, <u>supra</u> note 39, at 234.

- Does the lack of trading interest in insurance contracts support providing an exemption from Exchange Act reporting for securities that are regulated as insurance under state law? Should Exchange Act reporting be required notwithstanding the absence of trading interest and, if so, why? Are there any circumstances where trading interest in insurance contracts that are securities is significant enough that Exchange Act reporting should be required?

1. The Exemption

Proposed rule 12h-7 would provide an insurance company that is covered by the rule with an exemption from the duty under Section 15(d) of the Exchange Act to file reports required by Section 13(a) of the Exchange Act with respect to certain securities registered under the Securities Act.[78]

Covered Insurance Companies

The proposed Exchange Act exemption would apply to an issuer that is a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any state, including

---

78 Introductory paragraph to proposed rule 12h-7. Cf. Rule 12h-3(a) under the Exchange Act [17 CFR 240.12h-3(a)] (suspension of duty under Section 15(d) of the Exchange Act to file reports with respect to classes of securities held by 500 persons or less where total assets of the issuer have not exceeded $10,000,000); Rule 12h-4 under the Exchange Act [17 CFR 240.12h-4] (exemption from duty under Section 15(d) of the Exchange Act to file reports with respect to securities registered on specified Securities Act forms relating to certain Canadian issuers).

Section 15(d) of the Exchange Act requires each issuer that has filed a registration statement that has become effective under the Securities Act to file reports and other information and documents required under Section 13 of the Exchange Act [15 U.S.C. 78m] with respect to issuers registered under Section 12 of the Exchange Act [15 U.S.C. 78l]. Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] requires issuers of securities registered under Section 12 of the Act to file annual reports and other documents and information required by Commission rule.

the District of Columbia, Puerto Rico, the Virgin Islands, and any other possession of the United States.[79] In the case of a variable annuity contract or variable life insurance policy, the exemption would apply to the insurance company that issues the contract or policy. However, the exemption would not apply to the insurance company separate account in which the purchaser's payments are invested and which is separately registered as an investment company under the Investment Company Act of 1940 and is not regulated as an insurance company under state law.[80]

Covered Securities

The proposed exemption would apply with respect to securities that do not constitute an equity interest in the insurance company issuer and that are either subject to regulation under the insurance laws of the domiciliary state of the insurance company or are guarantees of securities that are subject to regulation under the insurance laws of that jurisdiction.[81] The exemption does not apply with respect to any other securities issued by an insurance company. As a result, if an insurance company issues securities with

---

79 Proposed rule 12h-7(a). The Exchange Act defines "State" as any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. Section 3(a)(16) of the Exchange Act [15 U.S.C. 78c(a)(16)]. The term "State" in proposed rule 12h-7 has the same meaning as in the Exchange Act. Proposed rule 12h-7 does not define the term "State," and our existing rules provide that, unless otherwise specifically provided, the terms used in the rules and regulations under the Exchange Act have the same meanings defined in the Exchange Act. See rule 240.0-1(b) [17 CFR 240.0-1(b)].

80 This approach is consistent with the historical practice of insurance companies that issue variable annuities and do not file Exchange Act reports. The associated separate accounts, however, are required to file Exchange Act reports. These Exchange Act reporting requirements are deemed to be satisfied by filing annual reports on Form N-SAR. 17 CFR 274.101. See Section 30(d) of the Investment Company Act [15 U.S.C. 80a-30(d)] and rule 30a-1 under the Investment Company Act [17 CFR 270.30a-1].

81 Proposed rule 12h-7(b).

respect to which the exemption applies, and other securities that do not entitle the insurer to the exemption, the insurer will remain subject to Exchange Act reporting obligations. For example, if an insurer that is a stock company[82] also issues insurance contracts that are registered securities under the Securities Act, the insurer generally would be required to file Exchange Act reports as a result of being a stock company. Similarly, if an insurer raises capital through a debt offering, the proposed exemption would not apply with respect to the debt securities.

We are proposing that the exemption be available with respect to securities that are either subject to regulation under the insurance laws of the domiciliary state of the insurance company or are guarantees of securities that are subject to regulation under the insurance laws of that jurisdiction.[83] We are proposing a broad exemption that would apply to any contract that is regulated under the insurance laws of the insurer's home state because we intend that the exemption apply to all contracts, and only those contracts, where state insurance law, and the associated regulation of insurer financial condition, applies. A key basis for the proposed exemption is that investors are already entitled to the financial condition protections of state law and that, under our federal system of regulation, Exchange Act reporting may be unnecessary. Therefore, we

---

[82] A stock life insurance company is a corporation authorized to sell life insurance, which is owned by stockholders and is formed for the purpose of earning a profit for its stockholders. This is in contrast to another prevailing insurance company structure, the mutual life insurance company. In this structure, the corporation authorized to sell life insurance is owned by and operated for the benefit of its policyowners. Black and Skipper, supra note 39, at 577-78.

[83] A domiciliary state is the jurisdiction in which an insurer is incorporated or organized. See National Association of Insurance Commissioners Model Laws, Regulations and Guidelines 555-1, § 104 (2007).

believe it is important that the reach of the exemption and the reach of state insurance law be the same.

The proposed Exchange Act exemption would apply both to certain existing types of insurance contracts and to types of contracts that are developed in the future and that are registered as securities under the Securities Act. The proposed exemption would apply to indexed annuities that are registered under the Securities Act. However, the proposed Exchange Act exemption is independent of proposed rule 151A and would apply to types of contracts in addition to those that are covered by proposed rule 151A. There are at least two types of existing insurance contracts with respect to which we intend that the proposed Exchange Act exemption would apply, contracts with so-called "market value adjustment" ("MVA") features and insurance contracts that provide certain guaranteed benefits in connection with assets held in an investor's account, such as a mutual fund, brokerage, or investment advisory account.

Contracts including MVA features have, for some time, been registered under the Securities Act.[84] Insurance companies issuing contracts with these features have also complied with Exchange Act reporting requirements.[85] MVA features have historically been associated with annuity and life insurance contracts that guarantee a specified rate of return to purchasers.[86] In order to protect the insurer against the risk that a purchaser

---

84 Securities Act Release. No. 6645, supra note 35, 51 FR at 20256-58.

85 See, e.g., ING Life Insurance and Annuity Company (Annual Report on Form 10-K (Mar. 31, 2008)); Protective Life Insurance Company (Annual Report on Form 10-K (Mar. 31, 2008)); Union Security Insurance Company (Annual Report on Form 10-K (Mar. 3, 2008)).

86 Some indexed annuities also include MVA features. See, e.g., Pre-Effective Amendment No. 4 to Registration Statement on Form S-1 of PHL Variable Insurance Company (File

may make withdrawals from the contract at a time when the market value of the insurer's assets that support the contract has declined due to rising interest rates, insurers sometime impose an MVA upon surrender. Under an MVA feature, the insurer adjusts the proceeds a purchaser receives upon surrender prior to the end of the guarantee period to reflect changes in the market value of its portfolio securities supporting the contract. As a result, if a purchaser makes a withdrawal at a time when interest rates are higher than at the time of contract issuance (and the market value of the insurer's assets has decreased), the proceeds payable upon surrender are adjusted downwards. By contrast, if interest rates are lower than at the time of contract issuance (and the market value of the insurer's assets has increased), the proceeds payable upon surrender are adjusted upwards.

More recently, some insurance companies have registered under the Securities Act insurance contracts that provide certain guarantees in connection with assets held in an investor's account, such as a mutual fund, brokerage, or investment advisory account.[87] As a result, the insurers become subject to Exchange Act reporting requirements if they are not already subject to those requirements. These contracts, often called "guaranteed living benefits," are intended to provide insurance to the purchaser against the risk of outliving the assets held in the mutual fund, brokerage, or investment

---

No. 333-132399) (filed Feb. 7, 2007); Initial Registration Statement on Form S-1 of ING USA Annuity and Life Insurance Company (File No. 333-133153) (filed Apr. 7, 2006); Pre-Effective Amendment No. 2 to Registration Statement on Form S-3 of Allstate Life Insurance Company (File No. 333-117685) (filed Dec. 20, 2004).

87 See, e.g., PHL Variable Life Insurance Company, File No. 333-137802 (Form S-1 filed Feb. 25, 2008); Genworth Life and Annuity Insurance Company, File No. 333-143494 (Form S-1 filed Apr. 4, 2008).

advisory account. An example of a guaranteed living benefit is a contract that guarantees regular income payments for the life of the purchaser to the extent that the value of the purchaser's investment in the relevant account is not sufficient to provide such payments. Such a contract could, for example, guarantee that if the purchaser withdraws no more than five percent per year of the amount invested, and if withdrawals and market performance reduce the account value to a zero balance, the insurer will thereafter make annual payments to the purchaser in an amount equal to five percent of the amount invested.

As noted above, the proposed Exchange Act exemption would also apply with respect to a guarantee of a security if the guaranteed security is subject to regulation under state insurance law.[88] We are proposing this provision because we believe that it would be appropriate to exempt from Exchange Act reporting an insurer that provides a guarantee of an insurance contract (that is also a security) when the insurer would not be subject to Exchange Act reporting if it had issued the guaranteed contract. This situation may arise, for example, when an insurance company issues a contract that is a security and its affiliate, also an insurance company, provides a guarantee of benefits provided under the first company's contract.[89]

Finally, the proposed exemption would be unavailable with respect to any security that constitutes an equity interest in the issuing insurance company. As a general matter,

---

88 The Securities Act defines "security" in Section 2(a)(1) of the Act [15 U.S.C. 77b(a)(1)]. That definition provides that a guarantee of any of the instruments included in the definition is also a security.

89 For example, an insurance company may offer a registered variable annuity, and a parent or other affiliate of the issuing insurance company may act as guarantor for the issuing company's insurance obligations under the contract.

an equity interest in an insurer would not be covered by the proposed exemption because it would not be subject to regulation under state insurance law and often would be publicly traded. Nonetheless, we believe that the rule should expressly preclude any security that constitutes an equity interest in the issuing insurance company from being covered by the proposed exemption. Where investors own an equity interest in an issuing insurance company, and are therefore dependent on the financial condition of the issuer for the value of that interest, we believe that they have a significant interest in directly evaluating the issuers' financial condition for themselves on an ongoing basis and that Exchange Act reporting is appropriate.

We request comment on the proposed exemption and in particular on the following issues:

- Should we provide insurance companies with an exemption from the duty under Section 15(d) of the Exchange Act to file reports required by Section 13(a) of the Exchange Act with respect to certain securities that are also regulated as insurance? Should we modify the exemption in any way?
- What securities should be covered by the proposed exemption? Should the exemption, as proposed, only be available with respect to securities that are either subject to regulation under state insurance law or are guarantees of securities that are subject to regulation under state insurance law? Should the exemption apply to indexed annuities, contracts with MVA features, and insurance contracts that provide certain guaranteed benefits in connection with assets held in an investor's account, such as a mutual fund, brokerage, or investment advisory account? Should we limit the exemption to all or any of those three types of securities, or

should we also make the exemption available to types of securities that may be issued by insurance companies in the future?

- If we adopt the proposed Exchange Act exemption, should the adopted rule expressly provide that the exemption is unavailable with respect to any security that constitutes an equity interest in the issuing insurance company? Should the rule expressly provide that the exemption is unavailable with respect to debt securities? If so, how should we define the term "debt securities" so that it does not cover insurance obligations?

2. Conditions to Exemption

As described above, we believe that the proposed exemption is necessary or appropriate in the public interest and consistent with the protection of investors because of the existence of state regulation of insurers' financial condition and because of the general absence of trading interest in insurance contracts. We are proposing that the Exchange Act exemption be subject to conditions that are designed to ensure that both of these factors are, in fact, present in cases where an insurance company is permitted to rely on the exemption.

Regulation of Insurer's Financial Condition

In order to rely on the proposed exemption, an insurer must file an annual statement of its financial condition with, and the insurer must be supervised and its financial condition examined periodically by, the insurance commissioner, bank commissioner, or any agency or any officer performing like functions, of the insurer's domiciliary state.[90] This condition is intended to ensure that an insurer claiming the exemption is, in fact, subject to state insurance regulation of its financial condition. Absent satisfaction of this condition, Exchange Act reporting would not be duplicative of state insurance regulation, and the proposed exemption would not be available.

Absence of Trading Interest

The proposed Exchange Act exemption would be subject to two conditions intended to insure that there is no trading interest in securities with respect to which the exemption applies. First, the securities may not be listed, traded, or quoted on an exchange, alternative trading system,[91] inter-dealer quotation system,[92] electronic communications network, or any other similar system, network, or publication for trading or quoting.[93] This condition is designed to ensure that there is no established trading market for the securities. Second, the issuing insurance company must take steps reasonably designed to ensure that a trading market for the securities does not develop, including requiring written notice to, and acceptance by, the insurance company prior to any assignment or other transfer of the securities and reserving the right to refuse assignments or other transfers of the securities at any time on a non-discriminatory

---

90 Proposed rule 12h-7(c). Cf. Section 26(f)(2)(B)(ii) and (iii) of the Investment Company Act [15 U.S.C. 80a-26(f)(2)(B)(ii) and (iii)] (using similar language in requirements that apply to insurance companies that sell variable insurance products).

91 For this purpose, "alternative trading system" would have the same meaning as in Regulation ATS. See 17 CFR 242.300(a) (definition of "alternative trading system").

92 For this purpose, "inter-dealer quotation system" would have the same meaning as in Exchange Act rule 15c2-11. See 17 CFR 240.15c2-11(e)(2) (definition of "inter-dealer quotation system").

93 Proposed rule 12h-7(d).

basis.[94] This condition is designed to ensure that the insurer takes reasonable steps to ensure the absence of trading interest in the securities. We recognize that insurance contracts typically permit assignment in some circumstances. The proposed condition is intended to permit these assignments to continue while requiring the insurer to monitor assignments and, if it observes development of trading interest in the securities, to step in and refuse assignments related to this trading interest. We understand that it is commonplace for insurers today to include restrictions on assignments in their contracts similar to those that would be required by the proposed rule.[95]

We request comment generally on the proposed conditions to the Exchange Act exemption and specifically on the following issues:

- Are the proposed conditions appropriate? Will they help to ensure that the proposed exemption is necessary or appropriate in the public interest and consistent with the protection of investors?
- Should we, as proposed, condition the exemption on the insurer filing an annual statement of its financial condition with its home state insurance regulator? Should we require more or less frequent filings relating to financial condition, e.g., quarterly, semi-annually, every two years, etc.?
- Should we require, as a condition to the exemption, any public disclosure of the insurer's financial condition, either through filing with us or by posting on the insurer's Web site? Should we require that an insurer post on its Web site, or make available to investors on request, any reports of financial condition that it

---

94 Proposed rule 12h-7(e).

95 See Roth, supra note 72, at 4 n. 4.

files with state insurance regulators or any third-party ratings of its claims-paying ability? Should we require, as a condition to the exemption, an insurer to report to the Commission, disclose to its contract owners, and/or publicly disclose any material disciplinary action undertaken, or material deficiency identified by, a state insurance regulator that relates to the insurer's financial condition or any other matter?

- Should we require, as a condition to the exemption, that the insurer be subject to supervision and periodic examination of its financial condition by its home state regulator, as proposed? Is the proposed condition consistent with state insurance regulation? Are there other conditions that should be imposed relating to supervision by the state insurance regulator?
- Should the Exchange Act exemption include conditions designed to limit trading interest in the securities? If so, are the proposed conditions appropriate? Does the proposed rule place appropriate restrictions on transfers of securities with respect to which the exemption is claimed without unduly restricting transfers in a manner that would be harmful to investors' interests?

IV. GENERAL REQUEST FOR COMMENTS

The Commission requests comment on the rules proposed in this release, whether any further changes to our rules are necessary or appropriate to implement the objectives of our proposed rules, and on other matters that might affect the proposals contained in this release.

V. PAPERWORK REDUCTION ACT

A. Background

Proposed rule 151A contains no new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[96] However, we believe that proposed rule 151A would, if adopted, result in an increase in the disclosure burden associated with existing Form S-1 as a result of additional filings that would be made on Form S-1.[97] Form S-1 contains "collection of information" requirements within the meaning of the PRA. Although we are not proposing to amend Form S-1, we are submitting the Form S-1 "collection of information" ("Form S-1 (OMB Control No. 3235-0065)), which we estimate would increase as a result of proposed rule 151A, to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA.[98]

We adopted existing Form S-1 pursuant to the Securities Act. This form sets forth the disclosure requirements for registration statements that are prepared by eligible issuers to provide investors with the information they need to make informed investment decisions in registered offerings. We anticipate that indexed annuities that register under the Securities Act would generally register on Form S-1.[99]

---

96 44 U.S.C. 3501 et seq.

97 17 CFR 239.11.

98 44 U.S.C. 3507(d); 5 CFR 1320.11.

99 Some Securities Act offerings are registered on Form S-3 [17 CFR 239.13]. We do not believe that proposed rule 151A would have any significant impact on the disclosure burden associated with Form S-3 because we believe that very few insurance companies that issue indexed annuities would be eligible to register those contracts on Form S-3. In order to be eligible to file on Form S-3, an issuer, must, among other things, have filed Exchange Act reports for a period of at least 12 calendar months. General Instruction

The hours and costs associated with preparing disclosure, filing forms, and retaining records constitute reporting and cost burdens imposed by the collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The information collection requirements related to registration statements on Form S-1 are mandatory. There is no mandatory retention period for the information disclosed, and the information disclosed would be made publicly available on the EDGAR filing system.

B. Summary of Information Collection

Because proposed rule 151A would affect the number of filings on Form S-1 but not the disclosure required by this form, we do not believe that the amendments will impose any new recordkeeping or information collection requirements. However, we expect that some insurance companies will register indexed annuities in the future that they would not previously have registered. We believe this will result in an increase in the number of annual responses expected with respect to Form S-1 and in the disclosure

---

I.A.3. of Form S-3. Very few insurance companies that issue indexed annuities today are currently eligible to file Form S-3. Further, if we adopt the proposed Exchange Act reporting exemption, insurance companies that issue indexed annuities and rely on the exemption would not meet the eligibility requirements for Form S-3.

We also do not believe that the proposed rules would have any significant impact on the disclosure burden associated with reporting under the Exchange Act on Forms 10-K, 10-Q, and 8-K. As a result of proposed rule 12h-7, insurance companies would not be required to file Exchange Act reports on these forms in connection with indexed annuities that are registered under the Securities Act. While proposed rule 12h-7 would permit some insurance companies that are currently required to file Exchange Act reports as a result of issuing insurance contracts that are registered under the Securities Act to cease filing those reports, the number of such companies is insignificant compared to the total number of Exchange Act reporting companies.

burden associated with Form S-1. At the same time, we expect that, on a per response basis, proposed rule 151A would decrease the existing disclosure burden for Form S-1. This is because the disclosure burden for each indexed annuity on Form S-1 is likely to be lower than the existing burden per respondent on Form S-1. The decreased burden per response on Form S-1 would partially offset the increased burden resulting from the increase in the annual number of responses on Form S-1. We believe that, in the aggregate, the disclosure burden for Form S-1 would increase if proposed rule 151A were adopted.

C. Paperwork Reduction Act Burden Estimates

For purposes of the PRA, we estimate that our proposal will result in an annual increase in the paperwork burden for companies to comply with the Form S-1 collection of information requirements of approximately 60,000 hours of in-house company personnel time and approximately $72,000,000 for the services of outside professionals. These estimates represent the combined effect of an expected increase in the number of annual responses on Form S-1 and a decrease in the expected burden per response. These estimates include the time and the cost of preparing and reviewing disclosure, filing documents, and retaining records. Our methodologies for deriving the above estimates are discussed below.

We are proposing a new definition of "annuity contract" that, on a prospective basis, would define a class of indexed annuities that are <u>not</u> "annuity contracts" or "optional annuity contracts" for purposes of Section 3(a)(8) of the Securities Act, which provides an exemption under the Securities Act for certain insurance contracts. These indexed annuities would, on a prospective basis, be required to register under the Securities Act on Form S-1.[100]

Increase in Number of Annual Responses

For purposes of the PRA, we estimate that there would be an annual increase of 400 responses on Form S-1 as a result of the proposal. In 2007, there were 322 indexed annuity contracts offered.[101] For purposes of the PRA analysis, we assume that 400 indexed annuities will be offered each year. This allows for some escalation in the number of contracts offered in the future over the number offered in 2007. Our Office of Economic Analysis has considered the effect of the proposed rule on indexed annuity contracts with typical terms and has determined that these contracts would not meet the definition of "annuity contract" or "optional annuity contract" if they were to be issued after the effective date of the proposed rule, if adopted as proposed. Therefore, we assume that all indexed annuities that are offered will be registered, and that each of the 400 registered indexed annuities would be the subject of one response per year on Form S-1,[102] resulting in the estimated annual increase of 400 responses of Form S-1.

---

100 Some Securities Act offerings are registered on Form S-3, but we believe that very few, if any, insurance companies that issue indexed annuities would be eligible to register those contracts on Form S-3. See supra note 99.

101 NAVA, supra note 6, at 57.

102 Annuity contracts are typically offered to purchasers on a continuous basis, and as a result, an insurer offering an annuity contract that is registered under the Securities Act generally would be required to update the registration statement once a year. See Section 10(a)(3) of the Securities Act [15 U.S.C. 77j(a)(3)] (when prospectus used more than 9 months after effective date of registration statement, information therein generally required to be not more than 16 months old).

Decrease in Expected Hours Per Response

For purposes of the PRA, we estimate that there would be a decrease of 265 hours per response on Form S-1 as a result of our proposal. Current OMB estimates and recent Commission rulemaking estimate the hours per response on Form S-1 as 1,176.[103] The current hour estimate represents the burden for all issuers, both large and small. We believe that registration statements on Form S-1 for indexed annuities would result in a significantly lower number of hours per response, which, based on our experience with other similar contracts, we estimate as 600 hours per indexed annuity response on Form S-1. We attribute this lower estimate to two factors. First, the estimated 400 indexed annuity registration statements will likely be filed by far fewer than 400 different insurance companies,[104] and a significant part of the information in each of the multiple registration statements filed by a single insurance company will be the same, resulting in economies of scale with respect to the multiple filings. Second, many of the 400 responses on Form S-1 each year will be annual updates to registration statements for existing contracts, rather than new registration statements, resulting in a significantly lower hour burden than a new registration statement.[105] Combining our estimate of 600 hours per indexed annuity response on Form S-1 (for an estimated 400 responses) with the existing estimate of 1,176 hours per response on Form S-1 (for an estimated 471

---

103 See Securities Act Release No. 8878 (Dec. 19, 2007) [72 FR 73534, 73547 (Dec. 27, 2007)].

104 The 322 indexed annuities offered in 2007 were issued by 58 insurance companies. See NAVA, supra note 6, at 57.

105 See supra note 102.

responses),[106] our new estimate is 911 hours per response (((400 x 600) + (471 x 1,176))/871).

Net Increase in Burden

To calculate the total effect of the proposed rules on the overall compliance burden for all issuers, large and small, we added the burden associated with the 400 additional Forms S-1 that we estimate will be filed annually in the future and subtracted the burden associated with our reduced estimate of 911 hours for each of the current estimated 471 responses. We used current OMB estimates in our calculation of the hours and cost burden associated with preparing, reviewing, and filing Form S-1.

Consistent with current OMB estimates and recent Commission rulemaking,[107] we estimate that 25% of the burden of preparation of Form S-1 is carried by the company internally and that 75% of the burden is carried by outside professionals retained by the issuer at an average cost of $400 per hour.[108] The portion of the burden carried by outside professionals is reflected as a cost, while the burden carried by the company internally is reflected in hours.

The tables below illustrate our estimates concerning the incremental annual compliance burden in the collection of information in hours and cost for Form S-1.

---

106 See Supporting Statement to the Office of Management and Budget under the PRA for Securities Act Release No. 8878, available at: http://www.reginfo.gov/public/do/DownloadDocument?documentID=61283&version=1.

107 See Securities Act Release No. 8878, supra note 103, 72 FR at 73547.

108 Id. at n. 110 and accompanying text.

Incremental PRA Burden Due to Increased Filings

Estimated Increase in Annual Responses	Hours/Response	Incremental Burden (hours)
400	911	364,400

Incremental Decrease in PRA Burden Due to Decrease in Hours Per Response

Estimated Decrease in Hours/Response	Current Estimated Number of Annual Filings	Incremental Decrease in Burden (hours)
(265)	471	(124,800)

Summary of Change in Incremental Compliance Burden

Incremental Burden (hours)	25% Issuer (hours)	75% Professional (hours)	$400/hr. Professional Cost
240,000	60,000	180,000	$72,000,000

D. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comments to: (1) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information would have practical utility; (2) evaluate the accuracy of our estimate of the burden of the proposed collections of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology. We note that the PRA burden will depend on the number of indexed annuity contracts that, under any rule we adopt, are not "annuity contracts," and therefore will be required to register under the Securities Act. We have assumed, for purposes of the PRA, that all indexed annuities would not be "annuity contracts" under the rule and that, if the proposed rule were adopted, they would be required to be registered under the Securities Act. We request comment regarding this assumption and, more generally, on the percentage, or number, of indexed annuities that would be required to register under the Securities Act if the proposed rule were adopted.

Persons submitting comments on the collection of information requirements should direct the comments to OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy of the comments to Office of the Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303, with reference to File No S7-14-08. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-14-08, and be submitted to the Securities and Exchange Commission, Records Management Office, 100 F Street, NE, Washington, DC 20549-1110. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. COST/BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits imposed by its rules. Proposed rule 151A is intended to clarify the status under the federal securities laws of indexed annuities, under which payments to the purchaser are dependent on the performance of a securities index. Section 3(a)(8) of the Securities Act provides an exemption for certain insurance contracts. The proposed rule would prospectively define certain indexed annuities as not being "annuity contracts" or "optional annuity contracts" under this insurance exemption if the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract. With respect to these annuities, investors would be entitled to all the protections of the federal securities laws, including full and fair disclosure and sales practice protections. We are also proposing new rule 12h-7 under the Exchange Act, which would exempt certain insurance companies from Exchange Act reporting with respect to indexed annuities and certain other securities that are registered under the Securities Act and regulated as insurance under state law.

A. Benefits

Possible benefits of the proposed amendments include the following: (i) enhanced disclosure of information needed to make informed investment decisions about indexed annuities; (ii) sales practice protections would apply with respect to those indexed annuities that are outside the insurance exemption; (iii) greater regulatory certainty with regard to the status of indexed annuities under the federal securities laws; (iv) enhanced competition; and (v) relief from Exchange Act reporting obligations to insurers that issue certain securities that are regulated as insurance under state law.

Disclosure

Proposed rule 151A would extend the benefits of full and fair disclosure under the federal securities laws to investors in indexed annuities that, under the proposed rule, fall outside the insurance exemption. Without such disclosure, investors face significant obstacles in making informed investment decisions with regard to purchasing indexed annuities that expose investors to securities investment risk. Extending the federal securities disclosure regime to such indexed annuities that impose securities investment risk should help to provide investors with the information they need.

Disclosures that would be required for registered indexed annuities include information about costs (such as surrender charges); the method of computing indexed return (e.g., applicable index, method for determining change in index, caps, participation rates, spreads); minimum guarantees, as well as guarantees, or lack thereof, with respect to the method for computing indexed return; and benefits (lump sum, as well as annuity and death benefits). We think there are significant benefits to the disclosures provided under the federal securities laws. This information will be public and accessible to all investors, intermediaries, third party information providers, and others through the SEC's EDGAR system. Public availability of this information would be helpful to investors in making informed decisions about purchasing indexed annuities. The information would enhance investors' ability to compare various indexed annuities and also to compare indexed annuities with mutual funds, variable annuities, and other securities and financial products. The potential liability for materially false and misleading statements and omissions under the federal securities laws would provide additional encouragement for accurate, relevant, and complete disclosures by insurers that issue indexed annuities and by the broker-dealers who sell them.[109]

In addition, we believe that potential purchasers of indexed annuities that an insurer determines do not fall outside the insurance exemption under the proposed rule

109 See, e.g., Section 12(a)(2) of the Securities Act [15 U.S.C. 77l(a)(2)] (imposing liability for materially false or misleading statements in a prospectus or oral communication, subject to a reasonable care defense). See also Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)]; rule 10b-5 under the Exchange Act [17 CFR 240.10b-5]; Section 17 of the Securities Act [15 U.S.C. 77q] (general antifraud provisions).

may benefit from enhanced information available as a result of the proposed rule. An indexed annuity that is not registered under the Securities Act after the adoption of proposed rule 151A would reflect the insurer's determination that investors in the annuity would not receive more than the amounts guaranteed under the contract at least half the time. This information would help a purchaser to evaluate the value of the index-based return.

Sales Practice Protections

Investors would also benefit because, under the federal securities laws, persons effecting transactions in indexed annuities that fall outside the insurance exemption under proposed rule 151A would be required to be registered broker-dealers or become associated persons of a broker-dealer through a networking arrangement. Thus, the broker-dealer sales practice protections would apply to transactions in registered indexed annuities. As a result, investors who purchase these indexed annuities after the effective date of proposed rule 151A would receive the benefits associated with a registered representative's obligation to make only recommendations that are suitable. The registered representatives who sell registered indexed annuities would be subject to supervision by the broker-dealer with which they are associated. Both the selling broker-dealer and its registered representatives would be subject to the oversight of FINRA.[110] The registered broker-dealers would also be required to comply with specific

---

110 Cf. NASD Rule 2821 (recently adopted rule designed to enhance broker-dealers' compliance and supervisory systems and provide more comprehensive and targeted protection to investors regarding deferred variable annuities). See Order Approving FINRA's NASD Rule 2821 Regarding Members' Responsibilities for Deferred Variable Annuities (Approval Order), Securities Exchange Act Release No. 56375 (Sept. 7, 2007), 72 FR 52403 (Sept. 13, 2007) (SR-NASD-2004-183); Corrective Order, Securities

books and records, supervisory, and other compliance requirements under the federal securities laws, as well as be subject to the Commission's general inspections and, where warranted, enforcement powers.

Regulatory Certainty

Proposed rule 151A would provide the benefit of increased regulatory certainty to insurance companies that issue indexed annuities and the distributors who sell them, as well as to purchasers of indexed annuities. The status of indexed annuities under the federal securities laws has been uncertain since their introduction in the mid-1990s. Under existing precedents, the status of each indexed annuity is determined based on a facts and circumstances analysis of factors that have been articulated by the U.S. Supreme Court. Proposed rule 151A would bring greater certainty into this area by defining a class of indexed annuities that are outside the scope of the insurance exemption and by providing that an insurer's determination, in accordance with the proposed rule, would be conclusive.

Enhanced Competition

Proposed rule 151A may result in enhanced competition among indexed annuities, as well as between indexed annuities and other competing financial products, such as mutual funds and variable annuities. Proposed rule 151A would result in enhanced disclosure, and, as a result, more informed investment decisions by potential investors, which may enhance competition among indexed annuities and competing products. The greater clarity that results from proposed rule 151A may enhance

---

Exchange Act Release No. 56375A (Sept. 14, 2007), 72 FR 53612 (September 19, 2007) (SR-NASD-2004-183) (correcting the rule's effective date).

competition as well because insurers who may have been reluctant to issue indexed annuities while their status was uncertain may now decide to enter the market. Similarly, registered broker-dealers who currently may be unwilling to sell unregistered indexed annuities because of their uncertain regulatory status may become willing to sell indexed annuities that are registered, thereby increasing competition among distributors of indexed annuities. Further, we believe that the proposed Exchange Act exemption may enhance competition among insurance products and between insurance products and other financial products because the exemption may encourage insurers to innovate and introduce a range of new insurance contracts that are securities, since the exemption would reduce the regulatory costs associated with doing so. Increased competition may benefit investors through improvements in the terms of insurance products and other financial products, such as reductions of direct or indirect fees.

<u>Relief from Reporting Obligations</u>

In addition, the proposed exemption from Exchange Act reporting requirements with respect to certain securities that are regulated as insurance under state law would provide a cost savings to insurers. We have identified approximately 24 insurance companies that currently are subject to Exchange Act reporting obligations solely as a result of issuing insurance contracts that are securities and that we believe would, if we adopt proposed rule 12h-7, be exempted from Exchange Act reporting obligations.[111] We

---

[111] In addition, if we adopt both proposed rules 151A and 12h-7, insurers that currently are not Exchange Act reporting companies and that would be required to register indexed annuities under the Securities Act could avail themselves of the Exchange Act exemption and obtain the benefits of the exemption. We have not included potential cost savings to these companies in our computation because they are not currently Exchange Act reporting companies.

estimate that, each year, these insurers file an estimated 24 annual reports on Form 10-K, 72 quarterly reports on Form 10-Q, and 26 reports on Form 8-K.[112] Based on current cost estimates, we believe that the total estimated annual cost savings to these companies would be approximately $15,414,600.[113]

2. Costs

While our proposal would result in significant cost savings for insurers as a result of the proposed exemption from Exchange Act reporting requirements, we believe that there would be costs associated with the proposal. These would include costs associated with: (i) determining under proposed rule 151A whether amounts payable by the insurer under an indexed annuity are more likely than not to exceed the amounts guaranteed under the contract; (ii) preparing and filing required Securities Act registration statements with the Commission; (iii) printing prospectuses and providing them to investors;

---

112 These estimates are based on the requirement to file one Form 10-K each year and three Forms 10-Q each year, and on our review of the actual number of Form 8-K filings by these insurers in calendar year 2007.

113 This consists of $8,748,950 attributable to internal personnel costs, representing 49,994 burden hours at $175 per hour, and $6,665,600 attributable to the costs of outside professionals, representing 16,664 burden hours at $400 per hour. Our estimates of $175 per hour for internal time and $400 per hours for outside professionals are consistent with the estimates that we have used in recent rulemaking releases.

Our total burden hour estimate for Forms 10-K, 10-Q, and 8-K is 66,658 hours, which, consistent with current OMB estimates and recent Commission rulemaking, we have allocated 75% (49,994 hours) to the insurers internally and 25% (16,664 hours) to outside professional time. See Supporting Statement to the Office of Management and Budget under the PRA for Securities Act Release No. 8819, available at: http://www.reginfo.gov/public/do/DownloadDocument?documentID=42924&version=1. The total burden hour estimate was derived as follows. The burden attributable to Form 10-K is 52,704 hours, representing 24 Forms 10-K at 2,196 hours per Form 10-K. The burden attributable to Form 10-Q is 13,824 hours, representing 72 Forms 10-Q at 192 hours per Form 10-Q. The burden attributable to Form 8-K is 130 hours, representing 26 Forms 8-K at 5 hours per Form 8-K. The burden hours per response for Form 10-K (2,196 hours), Form 10-Q (192 hours), and Form 8-K (5 hours) are consistent with current OMB estimates.

(iv) entering into a networking arrangement with a registered broker-dealer for those entities that are not currently parties to a networking arrangement or registered as broker-dealers and that intend to distribute indexed annuities that are registered as securities;[114] (v) loss of revenue to insurance companies that determine to cease issuing indexed annuities; and (vi) diminished competition that may result if some insurance companies cease issuing indexed annuities.

Determination Under Proposed Rule 151A

Insurers may incur costs in performing the analysis necessary to determine whether amounts payable under an indexed annuity would be more likely than not to exceed the amounts guaranteed under the contract. This analysis calls for the insurer to analyze expected outcomes under various scenarios involving different facts and circumstances. Insurers routinely undertake such analyses for purposes of pricing and hedging their contracts.[115] As a result, we believe that the costs of undertaking the analysis for purposes of the proposed rule may not be significant. However, the determinations necessary under the proposed rule may result in some additional costs for insurers that issue indexed annuities, either because the timing of the determination does not coincide with other similar analyses undertaken by the insurer or because the level or type of actuarial and legal analysis that the insurer would determine is appropriate under

---

114 While some distributors may register as broker-dealers or cease distributing indexed annuities that would be required to be registered as a result of proposed rule 151A, based on our experience with insurance companies that issue insurance products that are also securities, we believe that the vast majority would continue to distribute those indexed annuities via networking arrangements with registered broker-dealers, as discussed below.

115 See generally Black and Skipper, supra note 39, at 26-47, 890-899.

the proposed rule is different or greater than that undertaken for other purposes, or for other reasons. These costs, if any, could include the costs of software, as well as the costs of internal personnel and external consultants (e.g., actuarial, accounting, legal).

Securities Act Registration Statements

Insurers will incur costs associated with preparing and filing registration statements for indexed annuities that are outside the insurance exemption as a result of proposed rule 151A. These include the costs of preparing and reviewing disclosure, filing documents, and retaining records. As noted above, our Office of Economic Analysis has considered the effect of the proposed rule on indexed annuity contracts with typical terms and has determined that these contracts would not meet the definition of "annuity contract" or "optional annuity contract" if they were issued after the effective date of the proposed rule, if adopted as proposed. For purposes of the PRA, we have estimated an annual increase in the paperwork burden for companies to comply with the proposed rules to be 60,000 hours of in-house company personnel time and $72,000,000 for services of outside professionals. We estimate that the additional burden hours of in-house company personnel time would equal total internal costs of $10,500,000[116] annually, resulting in aggregate annual costs of $82,500,000[117] for in-house personnel and outside professionals. These costs reflect the assumption that filings will be made on Form S-1 for 400 contracts each year, which we made for purposes of the PRA.

---

116 This cost increase is estimated by multiplying the total annual hour burden (60,000 hours) by the estimated hourly wage rate of $175 per hour. Consistent with recent rulemaking releases, we estimate the value of work performed by the company internally at a cost of $ 175 per hour.

117 $10,500,000 (in-house personnel) + $72,000,000 (outside professionals).

Costs of Printing Prospectuses and Providing them to Investors

Insurers will also incur costs to print and provide prospectuses to investors for indexed annuities that are outside the insurance exemption as a result of proposed rule 151A. For purposes of the PRA, we have estimated that registration statements would be filed for 400 indexed annuities per year. We estimate that it would cost $0.35 to print each prospectus and $1.21 to mail each prospectus,[118] for a total of $1.56 per prospectus.[119] These estimates would be reduced to the extent that prospectuses are delivered in person or electronically, or to the extent that Securities Act prospectuses are substituted for written materials used today, rather than being delivered in addition to those materials.

Networking Arrangements with Registered Broker-Dealers

Proposed rule 151A may impose costs on indexed annuity distributors that are not currently parties to a networking arrangement or registered as broker-dealers. While these entities may choose to register as broker-dealers, in order to continue to distribute indexed annuities that are registered as securities, these distributors would likely enter

---

118 These estimates reflect estimates provided to us by Broadridge Financial Solutions, Inc., in connection with our recent proposal to create a summary prospectus for mutual funds. The estimates depend on factors such as page length and number of copies printed and not on the content of the disclosures. Because we believe that these factors may be reasonably comparable for indexed annuity and mutual fund prospectuses, we believe that it is reasonable to use these estimates in the context of indexed annuities. See Memorandum to File number S7-28-07 regarding October 27, 2007 meeting between Commission staff members and representatives of Broadridge Financial Solutions, Inc. (Nov. 28, 2007). The memorandum is available for inspection and copying in File No. S7-28-07 in the Commission's Public Reference Room and on the Commission's Web site at http://www.sec.gov/comments/s7-28-07/s72807-5.pdf.

119 We note that we solicit specific comment on the average number of prospectuses that would be provided each year to offerees and/or purchasers of a registered indexed annuity. This information may assist us in estimating an aggregate cost for printing and providing prospectuses.

into a networking arrangement with a registered broker-dealer. Under these arrangements, an affiliated or third-party broker-dealer provides brokerage services for an insurance agency's customers, in connection with transactions in insurance products that are also securities. Entering into a networking arrangement would impose costs associated with contracting with the registered broker-dealer regarding the terms, conditions, and obligations of each party to the arrangement. We anticipate that a distributor would incur legal costs in connection with entering into a networking arrangement with a registered broker-dealer, as well as ongoing costs associated with monitoring compliance with the terms of the networking arrangement.[120]

Possible Loss of Revenue

Insurance companies that determine that indexed annuities are outside the insurance exemption under proposed rule 151A could either choose to register those annuities under the Securities Act or to cease selling those annuities. If an insurer ceases selling such annuities, the insurer may experience a loss of revenue. The amount of lost revenue would depend on actual revenues prior to effectiveness of the proposed rules and to the particular determinations made by insurers regarding whether to continue to issue registered indexed annuities. The loss of revenue may be offset, in whole or in part, by gains in revenue from the sale of other financial products, as purchasers' need for financial products will not diminish. These gains could be experienced by the same insurers who exit the indexed annuity business or they could be experienced by other insurance companies or other issuers of securities or other financial products.

120 We note that we solicit specific comment on the number of entities that are distributors of indexed annuities, and on how many are parties to a networking arrangement.

Possible Diminished Competition

There could be costs associated with diminished competition as a result of our proposed rules. In order to issue indexed annuities that are outside the insurance exemption under proposed rule 151A, insurers would be required to register those annuities as securities. If some insurers determine to cease issuing indexed annuities rather than undertake the analysis required by proposed rule 151A and register those annuities that are outside the insurance exemption under the proposed rule, there will be fewer issuers of indexed annuities, which may result in reduced competition. Any reduction in competition may affect investors through potentially less favorable terms of insurance products and other financial products, such as increases in direct or indirect fees. Any reduction in competition must be considered in conjunction with the potential enhancements to competition that are described in the Benefits section, above.

B. Request for Comments

We request comments on all aspects of this cost/benefit analysis, including identification of any additional costs or benefits that may result from the proposed amendments. We also solicit comment on any alternatives to the proposal in light of the cost-benefit analysis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible. In particular, we request comment on the following issues:

- Are our quantitative estimates of benefits and costs correct? If not, how should they be adjusted?
- What are the costs associated with determining whether amounts payable under an indexed annuity would be more likely than not to exceed the amounts

guaranteed under the contract? Are valuation and hedging models currently in use readily adaptable for the purposes of this calculation? How much, if any, additional cost would this represent for insurers over and above the costs they routinely incur for the analysis necessary for pricing and hedging contracts, or for other purposes?

- We have estimated that 400 indexed annuity contracts would be registered on Form S-1 each year. Is this an accurate estimate, or is it too high or too low? What percentage of indexed annuities currently offered would not be considered "annuity contracts" or "optional annuity contracts" under proposed rule 151A?
- What would the costs of printing and providing prospectuses be for indexed annuities that are outside the insurance exemption under proposed rule 151A? What would the per prospectus printing and mailing costs be? On average, how many prospectuses would be provided each year for a registered indexed annuity to offerees and/or purchasers? To what degree would prospectuses be delivered by mail, in person, or electronically? To what degree would Securities Act prospectuses be provided in lieu of written materials used today?
- What are the costs of entering into a networking arrangement with a registered broker-dealer? How many entities currently distribute indexed annuities? Of those, how many have entered into a networking arrangement to sell other insurance products that are also securities (i.e., variable annuities)? How many have registered as broker-dealers to sell other insurance products that are also securities?

- How much revenue would be lost by insurers that determine to cease issuing indexed annuities? Would this lost revenue be offset by revenue gains of these insurance companies or by revenue gains of others? If so, by how much?

VII. CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION; CONSIDERATION OF BURDEN ON COMPETITION

Section 2(b) of the Securities Act[121] and Section 3(f) of the Securities Exchange Act[122] require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Section 23(a)(2) of the Exchange Act[123] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We believe that proposed rule 151A would promote efficiency by extending the benefits of the disclosure and sales practice protections of the federal securities laws to indexed annuities that are more likely than not to provide payments that vary with the performance of securities. The required disclosures would enable investors to make more informed investment decisions, and investors would receive the benefits of the sales practice protections, including a registered representative's obligation to make only

---

121 15 U.S.C. 77b(b).

122 15 U.S.C. 78c(f).

123 15 U.S.C. 78w(a)(2).

recommendations that are suitable. We believe that these investor protections would provide better dissemination of investment-related information, enhance investment decisions by investors, and, ultimately, lead to greater efficiency in the securities markets.

We also anticipate that, because proposed rule 151A would improve investors' ability to make informed investment decisions, it would lead to increased competition between issuers and sellers of indexed annuities, mutual funds, variable annuities, and other financial products, and increased competitiveness in the U.S. capital markets. The greater clarity that results from proposed rule 151A also may enhance competition because insurers who may have been reluctant to issue indexed annuities, while their status was uncertain, may decide to enter the market. Similarly, registered broker-dealers who currently may be unwilling to sell unregistered indexed annuities because of their uncertain regulatory status may become willing to sell indexed annuities that are registered, thereby increasing competition among distributors of indexed annuities.

Proposed rule 151A might have some negative effects on competition. In order to issue indexed annuities that are outside the insurance exemption under proposed rule 151A, insurers would be required to register those annuities as securities. If some insurers determine to cease issuing indexed annuities rather than undertake the analysis required by proposed rule 151A and register those annuities that are outside the insurance exemption under the proposed rule, there will be fewer issuers of indexed annuities, which may result in reduced competition. Any reduction in competition must be considered in conjunction with the potential enhancements to competition that are described in the preceding paragraph.

We also anticipate that the increased market efficiency resulting from enhanced investor protections under proposed rule 151A could promote capital formation by improving the flow of information between insurers that issue indexed annuities, the distributors of those annuities, and investors.

Proposed rule 12h-7 would provide insurance companies with an exemption from Exchange Act reporting with respect to indexed annuities and certain other securities that are regulated as insurance under state law. We have proposed this exemption because the concerns that Exchange Act financial disclosures are intended to address are generally not implicated where an insurer's financial condition and ability to meet its contractual obligations are subject to oversight under state law and where there is no trading interest in an insurance contract. Accordingly, we believe that the proposed exemption would improve efficiency by eliminating potentially duplicative and burdensome regulation relating to insurers' financial condition. Furthermore, we believe that proposed rule 12h-7 would not impose any burden on competition. Rather, we believe that the proposed rule would enhance competition among insurance products and between insurance products and other financial products because the exemption may encourage insurers to innovate and introduce a range of new insurance contracts that are securities, since the exemption would reduce the regulatory costs associated with doing so. We also anticipate that the innovations in product development could promote capital formation by providing new investment opportunities for investors.

We request comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. We also request comment on any anti-competitive effects of the proposed rules. Commenters are requested to provide empirical data and other factual support for their views.

VIII. INITIAL REGULATORY FLEXIBILITY ANALYSIS

This Initial Regulatory Flexibility Analysis has been prepared in accordance with the Regulatory Flexibility Act.[124] It relates to the Commission's proposed rule 151A that would define the terms "annuity contract" and "optional annuity contract" under the Securities Act of 1933 and proposed rule 12h-7 that would exempt insurance companies from filing reports under the Securities Exchange Act of 1934 with respect to indexed annuities and other securities that are registered under the Securities Act, subject to certain conditions.

A. Reasons for, and Objective of, Proposed Amendments

We are proposing the definition of the terms "annuity contract" and "optional annuity contract" to provide greater clarity with regard to the status of indexed annuities under the federal securities laws. We believe this would enhance investor protection and would provide greater certainty to the issuers and sellers of these products with respect to their obligations under the federal securities laws. We are proposing the exemption from Exchange Act reporting because we believe that the concerns that periodic financial disclosures are intended to address are generally not implicated where an insurer's financial condition and ability to meet its contractual obligations are subject to oversight under state law and where there is no trading interest in an insurance contract.

---

[124] 5 U.S.C. 603 <u>et seq.</u>

B. Legal Basis

The Commission is proposing rules 151A and 12h-7 pursuant to the authority set forth in Sections 3(a)(8) and 19(a) of the Securities Act [15 U.S.C. 77c(a)(8) and 77s(a)] and Sections 12(h), 13, 15, 23(a), and 36 of the Exchange Act [15 U.S.C. 78l(h), 78m, 78o, 78w(a), and 78mm].

C. Small Entities Subject to the Proposed Rules

The Commission's rules define "small business" and "small organization" for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission.[125] Rule 0-10(a)[126] defines an issuer, other than an investment company, to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year.[127] No insurers currently issuing indexed annuities are small entities.[128] In

125 See rule 157 under the Securities Act [17 CFR 230.157]; rule 0-10 under the Exchange Act [17 CFR 240.0-10].

126 17 CFR 240.0-10(a).

127 Securities Act rule 157(a) [17 CFR 157(a)] generally defines an issuer, other than an investment company, to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year and it is conducting or proposing to conduct a securities offering of $5 million or less. For purposes of our analysis, however, we use the Exchange Act definition of "small business" or "small entity" because that definition includes more issuers than does the Securities Act definition and, as a result, assures that the definition we use would not itself lead to an understatement of the impact of the amendments on small entities.

128 The staff has determined that each insurance company that currently offers indexed annuities has total assets significantly in excess of $5 million. The staff compiled a list of indexed annuity issuers from four sources: AnnuitySpecs, Carrier List, http://www.annuityspecs.com/Page.aspx?s=carrierlist; Annuity Advantage, Equity Indexed Annuity Data, http://www.annuityadvantage.com/annuitydataequity.htm; Advantage Compendium, Current Rates, http://www.indexannuity.org/rates_by_carrier.htm; and a search of BEST'S COMPANY REPORTS (available on LEXIS) for indexed annuity issuers. The total assets of each

addition, no other insurers that would be covered by the proposed Exchange Act exemption are small entities.[129]

While there are no small entities among the insurers who are subject to the proposed rules, we note that there may be small entities among distributors of indexed annuities. Proposed rule 151A, if adopted as proposed, may affect indexed annuity distributors who are not currently parties to a networking arrangement or registered as broker-dealers. While these entities may choose to register as broker-dealers, in order to continue to distribute indexed annuities that are registered as securities, these distributors would likely enter into a networking arrangement with a registered broker-dealer.[130] Under these arrangements, an affiliated or third-party broker-dealer provides brokerage services for an insurance agency's customers, in connection with transactions in insurance products that are also securities. Entering into a networking arrangement would impose costs associated with contracting with the registered broker-dealer regarding the terms, conditions, and obligations of each party to the arrangement. We anticipate that a distributor would incur legal costs in connection with entering into a

---

insurance company issuer of indexed annuities were determined by reviewing the most recent BEST'S COMPANY REPORTS for each indexed annuity issuer.

129 The staff has determined that each insurance company that currently offers contracts that are registered under the Securities Act and that include so-called market value adjustment features or guaranteed benefits in connection with assets held in an investor's account has total assets significantly in excess of $5 million. The total assets of each such insurance company were determined by reviewing the Form 10-K of that company and, in some cases, BEST'S COMPANY REPORTS (available on LEXIS).

130 We note that we solicit specific comment on the number of entities that are distributors of indexed annuities, and on how many are parties to a networking arrangement. See Part VI., above.

networking arrangement with a registered broker-dealer, as well as ongoing costs associated with monitoring compliance with the terms of the networking arrangement.

Rule 0-10(c)[131] states that the term "small business" or "small organization," when referring to a broker-dealer that is not required to file audited financial statements prepared pursuant to rule 17a-5(d) under the Exchange Act,[132] means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization. Rule 0-1(a)[133] states that the term "small business" or "small organization," when used with reference to a "person," other than an investment company, means a "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less.

D. Reporting, Recordkeeping, and Other Compliance Requirements

Proposed rule 151A would result in Securities Act filing obligations for those insurance companies that, in the future, issue indexed annuities that fall outside the insurance exemption under proposed rule 151A, and proposed rule 12h-7 would result in the elimination of Exchange Act reporting obligations for those insurance companies that meet the conditions to the proposed exemption. As noted above, no insurance companies that currently issue indexed annuities or that would be covered by the proposed exemption are small entities.

---

131 17 CFR 240.0-10(c).

132 17 CFR 240.17a-5(d).

133 17 CFR 240.10(a).

However, proposed rule 151A may affect indexed annuity distributors that are small entities and that are not currently parties to a networking arrangement or registered as broker-dealers. While these entities may choose to register as broker-dealers, in order to continue to distribute indexed annuities that are registered as securities, these distributors would likely enter into a networking arrangement with a registered broker-dealer. Entities that enter into such networking arrangements would not be subject to ongoing reporting, recordkeeping, or other compliance requirements. If any of these entities were to choose to register as broker-dealers as a result of proposed rule 151A,[134] they would be subject to ongoing reporting, recordkeeping, and other compliance requirements applicable to registered broker-dealers. Compliance with these requirements, if applicable, would impose costs associated with accounting, legal, and other professional personnel, and the design and operation of automated and other compliance systems.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe that the proposed rules would not duplicate, overlap, or conflict with other federal rules.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

---

[134] See, e.g., Submission for OMB Review; Comment Request, OMB Control No. 3235-0012 [72 FR 39646 (Jul. 19, 2007)] (discussing the total annual burden imposed by Form BD).

- establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- further clarifying, consolidating, or simplifying the proposed requirements for small entities;
- using performance standards rather than design standards; and
- providing an exemption from the proposed requirements, or any part of them, for small entities.

Because no insurers that currently issue indexed annuities or that would be covered by the proposed Exchange Act exemption are small entities, consideration of these alternatives for those insurance companies is not applicable. Small distributors of indexed annuities that choose to enter into networking arrangements with registered broker-dealers, which we believe would be likely if proposed rule 151A were adopted, would not be subject to ongoing reporting, recordkeeping, or other compliance requirements. However, because some small distributors may choose to register as broker-dealers, we did consider the alternatives above for small distributors.

The Commission believes that different registration, compliance, or reporting requirements or timetables for small entities that distribute registered indexed annuities would not be appropriate or consistent with investor protection. The proposed rules would provide investors with the sales practice protections of the federal securities laws when they purchase indexed annuities that are outside the insurance exemption. These indexed annuities would be required to be distributed by a registered broker-dealer. As a result, investors who purchase these indexed annuities after the effective date of proposed rule 151A would receive the benefits associated with a registered representative's obligation to make only recommendations that are suitable. The registered representatives who sell registered indexed annuities would be subject to supervision by the broker-dealer with which they are associated, and the selling broker-dealers would be subject to the oversight of FINRA. The registered broker-dealers would also be required to comply with specific books and records, supervisory, and other compliance requirements under the federal securities laws, as well as to be subject to the Commission's general inspections and, where warranted, enforcement powers.

Different registration, compliance, or reporting requirements or timetables for small entities that distribute indexed annuities may create the risk that investors would receive lesser sales practice and other protections when they purchase a registered indexed annuity through a distributor that is a small entity. We believe that it is important for all investors that purchase indexed annuities that are outside the insurance exemption to receive equivalent protections under the federal securities laws, without regard to the size of the distributor through which they purchase. For those same reasons, the Commission also does not believe that it would be appropriate or consistent with investor protection to exempt small entities from the broker-dealer registration requirements when those entities distribute indexed annuities that fall outside of the insurance exemption under our proposed rules.

Through our existing requirements for broker-dealers, we have endeavored to minimize the regulatory burden on all broker-dealers, including small entities, while meeting our regulatory objectives. Small entities that distribute indexed annuities that are outside the insurance exemption under our proposed rule should benefit from the Commission's reasoned approach to broker-dealer regulation to the same degree as other entities that distribute securities. In our existing broker-dealer regulatory framework, we have endeavored to clarify, consolidate, and simplify the requirements applicable to all registered broker-dealers, and the proposed rules do not change those requirements in any way. Finally, we do not consider using performance rather than design standards to be consistent with investor protection in the context of broker-dealer registration, compliance, and reporting requirements.

G. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- whether there are any small entity insurance companies that would be affected by the proposed rules and, if so, how many and the nature of the potential impact of the proposed rules on these insurance companies;
- the number of small entity distributors of indexed annuities that may be affected by proposed rule 151A and the potential effect of the rule on these small entities; and
- any other small entities that may be affected by the proposed rules.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. These comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rules are adopted, and will be placed in the same public file as comments on the proposed rules themselves.

IX. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[135] a rule is "major" if it results or is likely to result in:

- an annual effect on the economy of $100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposal would be a ''major rule'' for purposes of SBREFA. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries; and
- any potential effect on competition, investment, or innovation.

X. STATUTORY AUTHORITY

The Commission is proposing the amendments outlined above under Sections 3(a)(8) and 19(a) of the Securities Act [15 U.S.C. 77c(a)(8) and 77s(a)] and Sections 12(h), 13, 15, 23(a), and 36 of the Exchange Act [15 U.S.C. 78l(h), 78m, 78o, 78w(a), and 78mm].

List of Subjects

17 CFR Parts 230 and 240

Reporting and recordkeeping requirements, Securities.

---

135 Pub. L. No. 104-21, Title II, 110 Stat. 857 (1996).

TEXT OF PROPOSED RULES

For the reasons set forth in the preamble, the Commission proposes to amend title 17, Chapter II, of the Code of Federal Regulations as follows:

PART 230 – GENERAL RULES AND REGULATONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z–3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll (d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

2. Add § 230.151A to read as follows:

§ 230.151A Certain contracts not "annuity contracts" or "optional annuity contracts" under section 3(a)(8).

(a) General. Except as provided in paragraph (c) of this section, a contract that is issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia, and that is subject to regulation under the insurance laws of that jurisdiction as an annuity is not an "annuity contract" or "optional annuity contract" under Section 3(a)(8) of the Securities Act (15 U.S.C. 77c(a)(8)) if:

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

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

(b) Determination of amounts payable and guaranteed. In making the determination under paragraph (a)(2) of this section:

(1) Amounts payable by the issuer under the contract shall be determined without reference to any charges that are imposed at the time of payment, but those charges shall be taken into account in computing the amounts guaranteed under the contract; and

(2) A determination by the issuer at or prior to issuance of the contract shall be conclusive, provided that:

(A) Both the methodology and the economic, actuarial, and other assumptions used in the determination are reasonable;

(B) The computations made by the issuer in support of the determination are materially accurate; and

(C) The determination is made not more than six months prior to the date on which the form of contract is first offered and not more than three years prior to the date on which the particular contract is issued.

(c) Separate accounts. This section does not apply to any contract whose value varies according to the investment experience of a separate account.

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

*   *   *   *   *

4. Add § 240.12h-7 to read as follows:

§ 240.12h-7 Exemption for issuers of securities that are subject to insurance regulation.

An issuer shall be exempt from the duty under section 15(d) of the Act (15 U.S.C. 78o(d)) to file reports required by section 13(a) of the Act (15 U.S.C. 78m(a)) with respect to securities registered under the Securities Act of 1933 (15 U.S.C. 77a et seq.), provided that:

(a) The issuer is a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State;

(b) The securities do not constitute an equity interest in the issuer and are either subject to regulation under the insurance laws of the domiciliary State of the issuer or are guarantees of securities that are subject to regulation under the insurance laws of that jurisdiction;

(c) The issuer files an annual statement of its financial condition with, and is supervised and its financial condition examined periodically by, the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of the issuer's domiciliary State;

(d) The securities are not listed, traded, or quoted on an exchange, alternative trading system (as defined in §242.300(a) of this chapter), inter-dealer quotation system (as defined in § 240.15c2-11(e)(2)), electronic communications network, or any other similar system, network, or publication for trading or quoting; and

(e) The issuer takes steps reasonably designed to ensure that a trading market for the securities does not develop, including requiring written notice to, and acceptance by, the issuer prior to any assignment or other transfer of the securities and reserving the right to refuse assignments or other transfers at any time on a non-discriminatory basis.

By the Commission.

Florence E. Harmon
Acting Secretary

June 25, 2008

Rule 151A Legal Analysis of Proposed Rule 151A and Release

PROPOSED RULE 151A
SEC Release Nos. 33-8933, 34-58022

1. "Individuals who purchase indexed annuities are exposed to significant investment risk – i.e. the volatility of the underlying index." (p. 5, 6) "Thus, individuals who purchase such indexed annuities are 'vitally interested in the investment experience'". (p. 27)

    a. The entire underlying contract value of a fixed index annuity ("FIA"), including the premium deposit plus all indexed interest added through the latest contract anniversary, is exposed to no investment risk. Only the amount of the current year interest addition fluctuates with changes in the index. While surrender charges are deducted if the consumer elects to surrender, that is a contract term, i.e., a known cost of exit, not an "investment risk" and is unrelated to "volatility in the underlying index."

    b. Most FIA products "reset" the index on each contract anniversary date at its then current level. This becomes the starting index level for the indexed interest calculation in the current contract year. The reset reduces the consumer's risk of volatility in the underlying index for the current income calculation.

    c. Guaranteed minimum values required by state insurance laws assures the consumer a minimum return no matter how the index performs over time.

    d. Most FIAs permit the consumer to elect fixed-rate interest for all or a portion of their annual interest addition.

    e. Because consumers have no risk of loss or reduction of contract values, the insurers bear the primary investment risks of managing their general account of securities to support consumer contract values. These risks, including interest rate and credit risk, among others, cause the values of general account securities to fluctuate, sometimes widely, and losses on assets are regularly realized by insurers, some very large. However, unlike separate account products, none of this risk is passed through to consumers. It is insurers who are "vitally interested" in the investment experience of their general account assets, not consumers.

2. "The annuities that 'traditionally and customarily' were offered at the time Congress enacted the insurance exemptions were fixed annuities that typically involved no investment risk to the purchaser." (p. 24) "In contrast, when the amounts payable by an insurer under an indexed annuity contract are more likely than not to exceed the amounts guaranteed under the contract, the purchaser assumes substantially different risks and benefits. 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." (p.25)

a. Traditional fixed-rate annuities commonly expose the consumer to fluctuating levels of annual "excess" interest, i.e., the interest addition above guaranteed minimums. That is the same type of "risk" an FIA consumer assumes. In either case, the consumer has no risk of loss of premium or prior credited interest (unless the policy is surrendered during the surrender period in which case there is a contract loss rather than an investment loss as explained above).

b. Traditional fixed-rate annuities would typically be expected to have a contract value in excess of the guaranteed minimums as a result of excess interest credits.

c. The amount of excess interest which will be credited to a traditional fixed-rate annuity is unknown by the consumer at the time of purchase, and the amounts of excess interest later credited are completely within the insurer's discretion, subject to guaranteed minimums. Yet, fixed-rate products, which have been sold for decades, are commonly evaluated under existing Rule 151 and deemed to be exempt from securities regulation if the requirements of that rule are met.

d. Notably in case the of traditional fixed-rate annuity products, the insurer's ability to credit excess interest beyond the guaranteed minimum will depend on the performance of the company's overall investment portfolio and therefore is determined "in whole or in part, by reference to the performance of a security, including a group or index of securities", as set forth in the first prong of proposed Rule 151A.

e. Many types of bank products and life insurance products not regulated as securities expose the consumers of such products to fluctuating levels of annual interest, but no fluctuation in underlying account balances. Indexed certificates of deposit, for example, as described on the SEC website, are very comparable to FIAs, but have never been subject to registration. This would create an unlevel playing field between banking type products and insurance products, if Rule 151A were adopted.

3. "Indexed annuities are attractive to purchasers because they promise to 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 ('VAs'), and open brokerage accounts." (p. 5)

a. Consumers buy FIAs primarily for safety of premium and to avoid exposing that portion of their savings to market volatility. Mutual funds and variable annuities place the entire contract value at risk, exactly what FIA buyers are seeking to avoid.

b. Index-linked interest gives the consumer an opportunity to earn an average annual interest rate which may be higher than could be earned on a traditional fixed-rate product. Historically, FIA interest credits average 1-2% higher than comparable fixed-rates.

c. FIA carriers have advertising rules which apply to company and agent advertising of products. In nearly all states these rules are mandated by insurance regulation. Virtually every FIA carrier (probably all) emphasizes in its advertising rules and materials that the index product is NOT a direct vehicle for participation in stock market related gains.

4. "Sales of the products have grown dramatically in recent years. This growth has, unfortunately, been accompanied by growth in complaints of abusive sales practices." (p. 8) "Patricia Struck, then President of the North American Securities Administrators Association ("NASAA") identified indexed annuities as among the most pervasive products involved in senior investment fraud." (p.16)

    a. The FIA market grew from $11.7 billion in 2002 to a high of $27.2 billion in 2005, and has remained level at $25.3 and $25.2 billion in 2006 and 2007, respectively.

    b. FIAs represented about 5% of the total individual annuity market in 2002, reached a high of 13% in 2005, and have declined to about 10% for 2006 and 2007.

    c. NAIC data reflects that fewer "closed confirmed" complaints have been made concerning FIAs than VAs or traditional fixed-rate annuities. "Closed confirmed" complaints are those lodged with a state insurance department and concluded in favor of the consumer.

    d. NASAA maintains no records of complaints. NASAA (and its member states) has been asked to provide support for its claims concerning FIA complaints but has provided nothing.

    e. The NBC Dateline segment, a portion of which was aired by the SEC in its open meeting on this topic, featured only one actual consumer.

5. "The often-complex features of these annuities have not been adequately disclosed to purchasers, and rapid growth has been fueled by the payment of outsize commissions that are funded by high surrender charges imposed over long periods, which can make these annuities particularly unsuitable for seniors and others who may need ready access to their assets." (p. 8)

    a. Disclosure and suitability procedures in connection with the sales of annuities – including FIAs - have evolved considerably in the last several years based on vigorous efforts of the NAIC, state insurance commissioners, and annuity writers. Most, if not all, FIA writers provide readable disclosure statements with FIA products and operate suitability programs consistent with NAIC standards.

    b. Commission levels are set by free-market competition. It is in the insurer's financial interest to pay the lowest level commission possible and still remain competitive.

    c. Commissions paid to sales agents typically average between 7-9% of the premium for an FIA product. However, none of the commissions are deducted from consumer account values, and the only fee the consumer ever pays is the surrender charge if and when they choose to surrender.

d. VAs and mutual funds frequently deduct an initial sales load from the starting account value and then impose annual fees of 1-2% of account value annually, regardless of whether that value has increased or decreased. Such sales loads and fees would often surpass the amount of any net surrender charge an FIA holder would incur upon election to surrender.

e. State insurance regulation requires the initial guaranteed contract value to be at least 87.5% of the premium deposited into a traditional fixed-rate annuity or FIA. This means the net surrender charge to the policyholder cannot exceed 12.5% in the first year. In subsequent years, the minimum guaranteed contract value increases with the addition of minimum guaranteed interest. This reduces the maximum net surrender charge percentage which may be imposed in subsequent contract years. Any initial gross surrender charge percentages above 12.5% typically permit the insurer to recoup a portion of bonus values that were added to the consumer's premium at inception of the policy and are thus a recovery by the company rather than a loss to the consumer as such.

6. "The average age of issuance for indexed annuities has been reported to be 64". (p. 16)

a. The average age of issuance for fixed annuities has been in the mid-60s for decades, long before the inception of the FIA market.

b. Principal-protected savings products naturally appeal most to persons entering their retirement years. At that point consumers tend to become less willing to expose their savings to market volatility and are looking for more conservative retirement vehicles.

c. FIA insurers do not "target" retirees. Rather, that's where the primary demand for principal-protected products resides.

d. As more consumers move into retirement they will be interested in guaranteed insurance retirement alternatives over at-risk securities products. This is a longstanding historical difference between fixed and variable products.

7. "In a joint examination conducted by the Commission, NASAA and FINRA, of "free lunch" seminars that are aimed at selling financial products, often to seniors, with a free meal as enticement, examiners identified potentially misleading sales materials and potential suitability issues relating to the products discussed at the seminars, which commonly included indexed annuities." (p. 17)

a. The "free lunch report" dealt with examinations of securities dealers and registered investments and evaluated their compliance with securities laws in "free lunch" seminar selling. It involved no examinations of sales by independent insurance agents who are the principal sellers of FIAs.

b. Within the 27-page text of the report, FIAs are mentioned in only three places as being among the types of products sold at the seminars subject to the examination, which also commonly included variable annuities, real estate investment trusts, mutual funds, private placements of speculative securities (such as oil and gas interests) and reverse mortgages.

c. "Free lunch" seminars are a global concern in the financial services industry and there is no basis for tying them to individual products including FIAs. Inappropriate marketing practices cut across all financial services – including many that are already under the jurisdiction of the SEC and FINA - and should be addressed on their own terms rather than being unfairly tied to specific product classifications.

8. "Indexed annuities typically provide that the guaranteed minimum value is equal to at least 87.5% of purchase payments, accumulated at an annual interest rate of between 1% and 3%. Assuming a guarantee of 87.5% of purchase payments, accumulated at 1% interest compounded annually, it would take approximately 13 years for a purchaser's guaranteed minimum value to be 100% of purchase payments." (p. 13)

a. Guaranteed minimum values are regulated by state insurance departments through the Standard Nonforfeiture Law for Individual Deferred Annuities ("SNF"). This law applies to all fixed annuities, whether fixed-rate or indexed.

b. Prior to changes adopted several years ago, the SNF laws as adopted in each state typically required a minimum guaranteed interest rate of 3%. Because interest rates over the last 10 years fell to low levels, some annuity writers exited the market to avoid losses resulting from low rates of investment yield on new general account assets compared to relatively high guaranteed rates to consumers. This led to a change in the SNF to permit lower guaranteed interest rates in certain circumstances.

c. The minimum guaranteed rate is now linked to the 5-Year Constant Maturity Rate reported by the Federal Reserve, subject to a low of 1% and a high of 3%. A writer of fixed annuities cannot elect to use the lowest rate of 1% if the linked formula to the 5-year constant maturity date would require a higher rate.

d. It is misleading to suggest that FIA contract holders bear investment risk because the guaranteed minimum value is only 87.5% of purchase payments and must accumulate over a long period to reach 100% of the purchase value. As explained above, the guaranteed minimum value is relevant in the early contract years only for purposes of creating a maximum surrender charge, and does not directly affect contract values in early contract years unless there is a surrender. Absent a surrender of the policy by the FIA contract holder, values are guaranteed to ratchet up over time and can never fall in any given year, with many policies providing further guaranteed accumulation floors for each of their underlying investment strategies.

9. "The proposed rule does not apply to contracts that are regulated under state insurance law as life insurance, health insurance, or any for of insurance other than an annuity. . ." (p. 29)

a. Variable life insurance, like variable annuities, is regulated as a security. The full investment risk is typically borne by the policyholder under variable life policies.

b. It would be inconsistent to exclude indexed life insurance, which is the life insurance counterpart to FIAs. Like FIAs, the index life market is relatively new and has grown significantly in the last 10 years. It must be assumed that the SEC would next move to treat indexed life products as securities if Rule 151A is adopted.

c. HSAs represent one of the newest innovations in the health insurance sector. Obviously many consumers invest some of their health dollars in market-oriented products under an HSA arrangement. HSAs and other health products may come under scrutiny by the SEC as well.

d. There is concern in the insurance industry that Rule 151A could be the beginning of a slippery slope towards greater regulation of the insurance industry by securities regulators. Given the various pressing issues facing the securities industry (e.g. sub-prime mortgages), there is a question whether securities regulation of such insurance products is the best use of securities regulatory resources, especially given these products have long been under the watchful eye of state insurance commissioners.

10. "Proposed rule 151A addresses the manner in which a determination would be made regarding whether the amounts payable by the insurance company under a contract are more likely than not to exceed the amounts guaranteed under the contract...We are proposing this principles-based approach because we believe that an insurance company should be able to evaluate anticipated outcomes under an annuity that it issues. Insurers routinely undertake such analysis for the purpose of pricing and hedging their contracts." (p. 36, 39)

a. Pricing models for FIAs are identical to models for fixed-rate annuities. There is no current aspect of that modeling that compares projected contract values to minimum guaranteed values at any particular point in time.

b. Key assumptions utilized in this modeling include investment income earned by the insurer on annuity reserves supported by general account securities (for which the consumer is not at risk), the cost of providing the annual indexed interest to policyholders (assumed to be comparable to the cost of providing fixed-rate interest), levels of penalty free withdrawals, death claims, annuitizations, surrenders, surrender charges, commission expense and policy issue costs.

c. If in any given contract year the minimum guaranteed value exceeds the contract value, an insurer typically makes an adjustment in the hedging process for that contact year. This may vary from year to year for a particular contract. However, for the great majority of annuities for most insurers – both FIAs and fixed-rate annuities – current contract values will exceed guaranteed minimum values.

d. The testing of whether contract values are more probable than not to exceed guaranteed minimum values would produce different results at different times over the expected life of the annuity.

e. This test being proposed by the SEC will be difficult to analyze for actuaries. It is not accurate to say that insurers routinely conduct such analyses.

11. "State insurance regulation is focused on insurance company solvency and the adequacy of insurers' reserves, with the ultimate purpose of ensuring that insurance companies are financially secure enough to meet their contractual obligations.... [I]nsurance companies are subject to periodic examination of their financial condition by state insurance regulators." (p. 48)

a. State insurance regulation is multi-faceted and is concerned as much about market conduct as it is about company solvency. The NAIC and the individual state insurance departments devote an equal if not greater amount of resources – in terms of staffing, monitoring, and priorities – to product and sales issues as they do to the financial condition of their regulated entities.

b. State insurance regulations cover, among other things:
   i. Suitability of insurance agent recommendations regarding annuities
   ii. Annuity disclosure and advertising
   iii. Replacements of annuities
   iv. Agent licensing and training, including specific training requirements for FIA's in several states
   v. Unfair trade practices, including misrepresentation of product terms and conditions
   vi. Enforcement actions and penalties for noncompliance with sales practices requirements

c. The NAIC and state insurance commissioners have expended considerable resources in recent years to strengthen annuities marketing laws. For example, several years ago the NAIC adopted a model regulation (the NAIC Suitability in Annuity Transactions Regulation) governing suitability in the sales of annuities, and work is under way to possibly strengthen the agent supervision provisions of that model regulation under a Working Group appointed by the NAIC's Life and Annuity "A" Committee. Similarly, the practice of using "senior designations" in a misleading manner, identified as a form of abusive sales technique last year, is the subject of a proposed NAIC model regulation.

d. In addition to regular exams of financial condition, insurers also undergo market conduct exams by the insurance regulators in their domiciliary states as well as any other states in which they do business.

12. "Possible benefits of the proposed amendments include: enhanced disclosure of information needed to make informed investment decisions about indexed annuities ..." (p. 69)

a. Insurers in 22 states have adopted the NAIC Annuity Disclosure Model Regulation. Most – if not all – of the major FIA insurance carriers have mandated the use of a disclosure statement or certificate describing all important terms and conditions of the annuity contract, including prominent disclosure of surrender charges. Both the consumer and sales agent are often required to sign these disclosure statements or certificates as a condition to policy issuance.

b. In many states agents are also required to deliver "Buyer's Guide to Fixed Deferred Indexed Annuities" to the consumer at the point of sale. This document was created by the NAIC.

c. Annuity contracts are subject to "Flesch" testing, which tests for reader comprehension at a 10^{th} grade level.

d. Additional disclosures are required if the sale involves a replacement of an existing annuity. The level of additional disclosure required varies by state.

e. Some states require additional disclosures to senior consumers.

f. Annuity buyers have the protection of "free look" periods of 10-30 days in which they can return the annuity contract after delivery and obtain a full refund. No such protection exists for sales of securities.

g. Many disclosure requirements and practices of FIA writers are at least as effective as prospectus disclosures, which tend to be overly complex and detailed and tend to go unread by consumers.

13. "Possible benefits of the proposed amendments include: ...sales practices protections..." (p. 69)

a. In addition to the disclosure requirements discussed above, suitability reviews are now required by regulation in 33 states.

b. Many – if not all – major FIA writers now conduct suitability reviews of all sales in all states regardless of whether the NAIC Model Suitability Regulation has been adopted in that state. Heightened scrutiny is often applies in certain cases, including for example those in which the annuity premium would exceed a certain percentage of the consumers net worth.

c. Suitability reviews required of brokers under FINRA rules would not add any meaningful protections over and above what is already being done by most FIA writers and their agents.

14. "Possible benefits of the proposed amendments include: .... enhanced competition" (p. 69).

a. Over 90% of FIA's are distributed by independent insurance agents, not broker dealers.

b. Requiring securities licensing of independent insurance agents who do not already possess such licenses (estimated 50-70% are not already licensed) may cause a significant number of them to exit the market.

c. When FINRA adopted NTM 05-50, which recommends heightened scrutiny and supervision by broker-dealers of FIA sales, a number of broker dealers greatly restricted the availability of these products through their distribution channel. This had the effect of decreasing competition in the market.

d. Insurers will be required to price the additional cost of broker-dealer selling concessions into the products. This will result in decreased benefits to consumers.

e. One likely response of FIA insurers and their agents will be to return their primary focus to traditional fixed-rate products. This will hurt consumers by limiting their choices among principal-protected products.

f. Many VA companies have not entered the FIA market because they can currently sell products which allocate all market risk to the consumer while the company earns significant annual fees regardless of investment performance. It is unlikely that VA writers will now enter the FIA market where they would assume general account market risk while earning a less predictable spread profit. This is particularly likely given that a significant number of current competitors (both agents and companies) will likely be forced out of the market due to the expensive hurdles to registered product development.

Rule 151A Old Mutual Q&A's

Questions and Answers about the SEC Proposal to classify Fixed Indexed Annuities as Securities

Q. Has the SEC moved to regulate the sale of fixed indexed annuities as securities?

A. On Wednesday, June 25, 2008, the SEC proposed a new rule to regulate most fixed indexed annuities as securities. The SEC takes the position that state insurance regulation of the sale of these annuities is inadequate to protect purchasers. According to the SEC, purchasers of fixed index annuities are "exposed to a significant investment risk—i.e., the volatility of the underlying securities index". Thus, the SEC is proposing that these contracts be registered so purchasers can receive a prospectus and product sales can be supervised by broker dealers.

Q. What is Old Mutual's (OM's) position on this issue?

A. OM supports efforts to improve sales practices and to better protect customers, but OM does not believe that the proposed rule is necessary in this regard. In addition, fixed indexed annuities are guaranteed products that are not subject to market risk in the manner of securities regulated by the SEC. Simply put, insurers offer fixed indexed annuities that provide significant guarantees under state insurance law that are not typical of securities.

Q. What is OM doing to respond?

A. OM is working with outside counsel and various trade groups and will share its views with the SEC as part of the comment process.

Q. What would be the impact of this proposed rule?

A. If adopted as proposed, the rule would require most fixed indexed annuities to be registered as a security with the SEC. As with other registered security offerings, sales would need to be preceded or accompanied by a prospectus, and only registered representatives of broker dealer firms could sell the product. The rule would add unnecessary and redundant disclosure to the sales process and likely impair the availability of fixed index annuities. Making fixed indexed annuities less readily available to the public would operate to deprive some consumers (those who do not have a brokerage account, for example) from access to the product's valuable guarantees.

Q. How valuable are the guarantees provided by fixed indexed annuities?

A. Given recent market turmoil, who has been better protected against significant investment risk—someone who bought a security, i.e., a stock mutual fund or an index fund, or a fixed indexed annuity, all of them tied to the same index? Some would say that recent statistics speak for themselves: as of Friday, June 27, 2008, the Dow Jones Industrial Average[i] has fallen almost 20% from its October, 2007 record while fixed indexed annuity purchasers have not lost any principal due to market performance.

OM offers a variety of fixed indexed annuities, some with index options based on the S&P 500 Index[ii], some based on the Dow Jones Index, and some with combinations of these indexes. We refer below to the Dow Jones Index only by way of example.

An investor who recently bought either a stock mutual fund or an index fund (each designed to track the Dow Jones Industrial Average) were, in the words of the SEC's release on fixed indexed annuities, "exposed to significant investment risk". Indeed, these purchasers have experienced losses in the neighborhood of 20% since last October. These purchasers also presumably received "the benefits of federally mandated disclosure and sales practice protections" which the SEC now wants to extend to purchasers of certain fixed indexed annuities that depend on the performance of a securities index.

The purchaser of a fixed indexed annuity with interest crediting tied to the Dow Jones Industrial Average--unlike the mutual fund or index fund investor-- has not lost 20% due to the drop in the Dow. Instead, the annuity interest crediting formula protects the annuity owner against loss due to negative drops in the index over the crediting period. Under the indexing formula guaranteed in the contract, a client may not receive any interest for a crediting period when the change in the Dow is negative. Many purchasers would prefer that result over a 20% loss of principal.

Although OM recognizes the benefits of federally mandated disclosures in the context of securities where the purchaser bears unlimited downside risk, we also recognize the limited usefulness of those same disclosures in the context of a guaranteed product such as a fixed indexed annuity.

The guarantees a fixed index annuity provides come with a price—one that is fully disclosed. If the markets measured by the relevant index have steadily increased during the crediting period, the purchaser of the fixed indexed annuity will generally receive less than the purchaser of a stock mutual fund or an index fund that tracks the same index, depending on any caps, participation rates or spreads that the fixed index annuity charges.

Q. What about the regulation of sales practices?

A. No one benefits from an unsuitable sale. OM is committed to assisting its producers in insuring that all sales are suitable for the client based on information the client provides.

A variety of distributors, including insurance agents, registered representatives of broker dealer and investment advisers currently offer fixed indexed annuities and traditional annuities to their clients. Although the SEC and/or FINRA already have jurisdiction today over some fixed indexed annuity sellers (registered representatives of broker dealers and investment advisory representatives) the SEC did not classify fixed indexed annuity sales practice complaints-- cited by the SEC as demonstrating the need for the proposed rule-- by type of distributor.

The SEC rule proposal ignores state insurance suitability requirements now in place in more than 35 jurisdictions. State insurance suitability obligations apply to **all** licensed insurance agents, including those who are registered representatives of broker dealers and investment adviser representatives.

OM believes that state insurance sales disclosure and sales practice protection laws and regulations applicable to fixed indexed annuities adequately protect consumers.

Q. What happens next?

A. The public has until September 10, 2008 to file comments on the proposed rule with the SEC. The SEC will meet again and decide, based on public comments, whether to adopt the rule as proposed or to publish a revised rule.

Q. How can I file a comment on this proposed rule?

A. Go to the SEC website at http://www.sec.gov/rules/proposed/2008/33-8933.pdf and follow the directions there; or, you may wish to participate in the comment process through trade associations you belong to.

Q. While the rule is pending, who can sell fixed indexed annuities?

A. The SEC has proposed that its rule to regulate fixed indexed annuities become effective one year after a final rule is adopted. In practical terms, unless the SEC opts for an earlier effective date, the earliest the new rule would become effective is September of 2009.

In the interim, our fixed indexed annuities may continue to be offered by insurance-only licensed representatives subject to state insurance suitability requirements. Sales by registered representatives of broker dealers and investment advisory representatives who are also licensed as insurance agents will continue to be subject to state insurance suitability rules, as well as applicable federal antifraud and suitability rules.

---

[i] **Dow Jones Index**

The Index is used for calculating any index interest credit. The index that will be used is the Dow Jones Industrial Average (which excludes dividends). "Dow Jones Industrial Average SM", and "DJIA SM" are service marks of Dow Jones & Company, Inc. Dow Jones has no relationship to OM Financial Life Insurance Company, other than the licensing of the Dow Jones Industrial Average (DJIA) and its service marks for use in connection with the Contract.

Dow Jones does not:

- Sponsor, endorse, sell or promote the Contract.
- Recommend that any person invest in the Contract or any other securities.
- Have any responsibility or liability for or make any decisions about the timing, amount or pricing of Contract.

Have any responsibility or liability for the administration, management or marketing of the Contract. Consider the needs of the Contract or the Owners of the Contract in determining, composing or calculating the Dow Jones Industrial Average or have any obligation to do so.

Dow Jones will not have any liability in connection with the Contract. Specifically, Dow Jones does not make any warranty, express or implied, and Dow Jones disclaims any warranty about:

- The results to be obtained by the Contract, the Owner of the Contract or any other person in connection with the use of Dow Jones will have no liability for any errors, omissions or interruptions in the Dow Jones Industrial Average or its data;
- The accuracy or completeness of the Dow Jones Industrial Average and its data;
- The merchantability and the fitness for a particular purpose or use of the Dow Jones Industrial Average and its data;
- The Dow Jones Industrial Average and the data included in the Dow Jones Industrial Average;

Under no circumstances will Dow Jones be liable for any lost profits or indirect, punitive, special or consequential damages or losses, even if Dow Jones knows that they might occur.

[ii] **S&P 500 Index**

The Index, which is used for calculating any index interest credits, is the Standard & Poor's 500 Composite Stock Price Index (which excludes dividends). The Product is not sponsored, endorsed, sold or promoted by Standard & Poor's, a division of the McGraw-Hill Companies, Inc. ("S&P"). S&P makes no representation or warranty, express or implied, to the owners of the Product or any member of the public regarding the advisability of investing in securities generally or in the Product particularly or the ability of the S&P 500 Index to track general stock market performance. S&P's only relationship to the Licensee is the licensing of certain trademarks and trade names of S&P and of the S&P 500 Index which is determined, composed and calculated by S&P without regard to the Licensee or the Product.

S&P has no obligation to take the needs of the Licensee or the owners of the Product into consideration in determining, composing or calculating the S&P 500 Index. S&P is not responsible for and has not participated in the determination of the prices and amount of the Product or the timing of the issuance or sale of the Product or in the determination or calculation of the equation by which the Product is to be converted into cash. S&P has no obligation or liability in connection with the administration, marketing or trading of the Product.

S&P DOES NOT GUARANTEE THE ACCURACY AND/OR THE COMPLETENESS OF THE S&P 500 INDEX OR ANY DATA INCLUDED THEREIN AND S&P SHALL HAVE NO LIABILITY FOR ANY ERRORS, OMISSIONS, OR INTERRUPTIONS THEREIN. S&P MAKES NO WARRANTY, EXPRESS OR IMPLIED, AS TO RESULTS TO BE OBTAINED BY LICENSEE, OWNERS OF THE PRODUCT, OR ANY OTHER PERSON OR ENTITY FROM THE USE OF THE S&P 500 INDEX OR ANY DATA INCLUDED THEREIN. S&P MAKES NO EXPRESS OR IMPLIED WARRANTIES, AND EXPRESSLY DISCLAIMS ALL WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE WITH RESPECT TO THE S&P 500 INDEX OR ANY DATA INCLUDED THEREIN. WITHOUT LIMITING ANY OF THE FOREGOING, IN NO EVENT SHALL S&P HAVE ANY LIABILITY FOR ANY SPECIAL, PUNITIVE, INDIRECT, OR CONSEQUENTIAL DAMAGES (INCLUDING LOST PROFITS), EVEN IF NOTIFIED OF THE POSSIBILITY OF SUCH DAMAGES.

Overview of Suitability Review Process

COMPANY SUITABILITY EFFORTS

OVERVIEW OF SUITABILITY REVIEW PROCESS

- We require that a completed Suitability Acknowledgement Form accompany every deferred annuity application. (See "Annuity Suitability Acknowledgement Form" attached.)

- We do not allow an applicant to "opt out" of providing a completed Suitability Acknowledgement Form.

- The Suitability Acknowledgement Form is screened upon receipt to determine if the applicant has indicated responses on the form that may raise a "red flag" in processing.

- If "red flags" are noted, a letter is sent to the producer requesting additional information demonstrating whether the sale is suitable.

- "Red flag" triggers include response of a certain nature or range in regard to:

    - liquidity
    - goals
    - composition of assets
    - surrender charges
    - monthly disposable income

- "Red flags" are reviewed monthly in the Compliance Department and additional follow-up is done which includes discussions with operations, sales and marketing as follows:

    - A review of all information provided by the producer and contained in the application file is conducted
    - A decision is made based on this review. Possible results include:
    - ➢ An offer of rescission to the applicant
    - ➢ Termination or other discipline of the producer
    - ➢ Further investigation and information requests
    - ➢ Additional training of a producer or agency

LIMRA CAP SURVEY REVIEW PROCEDURES

- We participate in the LIMRA Customer Assurance Program ("LIMRA CAP") which involves a customer survey designed to verify the appropriateness of a sale by permitting the applicant an independent manner of providing feed back to us.

- The actual mailing and collection of LIMRA CAP surveys is independently managed by LIMRA International, Inc. LIMRA International, Inc. is a non-profit organization devoted, among other things, to the promotion of good market practices within the insurance industry.

- Subsequent to receipt of an application for a deferred annuity, LIMRA CAP sends out surveys to Company clients who have purchased fixed annuities on a monthly basis; analyzes the results that are received back from policyholders and provides a report that reflects the results of the survey for that month and the past 12 months and compares it with all other LIMRA CAP clients as well as with a group of peer companies

- We review the monthly LIMRA CAP reports and each client survey response to identify any responses that contain any significant items of potential concern expressed in the comments section. In certain situations – unreformed evidence of confusion, misunderstanding or lack of suitability in the sale, we will offer an applicant the opportunity to rescind.

- We also review the LIMRA CAP surveys on a monthly basis in order to identify any trends which would require follow-up with any specific producers.

Annuity Suitability Acknowledgement Form

OLD MUTUAL
INVEST INSURE INNOVATE

INSURER – OM Financial Life Insurance Company

1. **THIS FORM HELPS YOU.** It is important you have the information you need to determine if purchasing a fixed annuity contract meets your needs for your financial situation. This form can help you make that determination.

2. **CUSTOMER PROFILE**

Owner's Name ____________________ Age ______ Occupation __________________________

Monthly Disposable Income (***monthly income minus monthly expenses***): ________________

Net worth excluding equity in primary residence: ________________

What is your marginal federal tax rate? ___ **0%** ___ **10%** ___ **15%** ___ **25%** ___ **28%** ___ **33%** ___ **35%**

Which goal is most important to you with respect to this OM Life Annuity you are purchasing?

__ Retirement __ Principal Protection __ Tax Deferral __ Wealth Accumulation __ Emergencies __ College Funding

__ Guaranteed Income __ Vacations

Please list the amount of current savings and investments below:

Checking/Savings/Money Market	$_________	Primary Residence	$_________
Certificates of Deposit	$_________	Other Real Estate	$_________
Fixed Annuities	$_________	Mutual Funds	$_________
Variable Annuities	$_________	Stocks/Bonds	$_________
Life Insurance Cash Value	$_________	Retirement Plans	$_________

This annuity transaction represents approximately what percentage of your assets (excluding primary home)?

☐ 0 – 25% ☐ 25% - 50% ☐ 50% - 75% ☐ 75% - 100%

Is this a replacement of an annuity or a life contract/? ____ Yes ___ No

a) **If yes**, is there a penalty for early termination (surrender charge)? _____ Yes _____ No
b) If there is a penalty or surrender charge, what percentage of the contract value being replaced will be subject to a penalty? ___0-2% ___ 3-5% ___ 6-8% ___ 9% or >

3. **ACKNOWLEDGEMENT AND SIGNATURE**

I understand that:

- I have applied for and/or purchased an annuity contract. This is NOT a short-term savings vehicle.
- The premiums I pay for the annuity contract apply to a fixed annuity contract – not a mutual fund, savings account, certificate of deposit, security or other financial product.
- Certain cash withdrawals from, or a complete surrender of, the contract are subject to certain limitations and charges as described in the contract. I understand that the annuity contract permits certain charge-free withdrawal amounts; I believe these amounts are more than sufficient to meet my income and other financial needs.
- Surrender/redemption charges/fees may be incurred as a result of liquidating existing accounts in order to fund this annuity.
- Income tax liability may be incurred as a result of withdrawals and/or liquidating my existing accounts; however, I believe this transaction to be in my best interest.
- The Agent/Representative and OM Financial Life may not offer tax advice, and I am responsible for the tax consequences, if any, related to this transaction. If needed, I will consult with my own professional tax advisor.
- The Agent/Representative and OM Financial Life may rely upon the information provided herein, and the information provided herein is true and accurate to the best of my knowledge.
- I value the product features this contract provides, including its guarantees.

______________________________ ______________________
Owner's Signature Date

______________________________ ______________________
Joint Owner's Signature (if applicable) Date

______________________________ ______________________
Agent Signature Date

OLD MUTUAL
INVEST INSURE INNOVATE

Dear OM Financial Life Insurance Company Customer:

We appreciate your recent purchase and would like to take this opportunity to assure you of our commitment to serving the needs of customers such as yourself. You can help us do a better job of service by telling us why and how you recently decided to purchase an Annuity product from OM Financial Life Insurance Company.

Please take a moment to complete this brief questionnaire, place it in the enclosed business reply envelope, and drop it in the mail — no stamp is required. We have asked LIMRA, an independent research organization, to conduct this survey for us.

If you have any questions about your purchase or if we can provide any other assistance, please contact your agent or our customer service department at 1-888-513-8797.

Cordially,

Bruce G. Parker Jr.

Bruce G. Parker Jr.
President
Old Mutual Financial Life Insurance Company

1. *Based on your recent experience, how helpful was:*

	Extremely	Very	Somewhat	Not Very	Not at All
a. The service provided by the agent?	☐1	☐2	☐3	☐4	☐5
b. Our product descriptions and sales materials?	☐1	☐2	☐3	☐4	☐5

2. What product(s) have you recently purchased from our company? *(Mark all that apply.)*

Yes	No	
☐1	☐2	Annuities
☐1	☐2	Life insurance
☐1	☐2	Some other type of insurance

(If you did not buy an annuity, please skip to Question 7.)

3. Please indicate which of the following apply to the annuity you purchased by checking "yes," "no," or "not sure" for each feature listed. *(Please answer for every feature listed.)* Then ✓ which features were very important in your purchase decision.

Annuity Features/Benefits	Yes	No	Not Sure	Very Important
a. It provides tax-deferred savings.	☐1	☐2	☐3	☐
b. Surrender charges are imposed on premature full withdrawal.	☐1	☐2	☐3	☐
c. There may be tax penalties on any withdrawals prior to age 59½.	☐1	☐2	☐3	☐
d. I understand that this product is not life insurance.	☐1	☐2	☐3	☐
e. It can provide an income stream at retirement.	☐1	☐2	☐3	☐
f. The interest I earn on this product is linked to performance indices (such as S&P 500) and is not the result of direct investment in the stock market.	☐1	☐2	☐3	☐

4. What sources of money are you using/did you use to pay for the annuity you recently purchased? *(Mark all that apply.)*

- ☐ Current income
- ☐ Savings (savings account or Certificate of Deposit (CD))
- ☐ Investments (mutual funds, stocks, bonds, etc.)
- ☐ *Inheritance or death benefit proceeds*
- ☐ Rollover of money from a pension or retirement plan
- ☐ Money from another annuity
- ☐ Money from a life insurance policy
- ☐ Other

5. a. Did your agent review your financial status, tax status, investment objectives, and other pertinent information to determine whether this annuity purchase is suitable for you at this time? ☐1 Yes ☐2 No

b. *If no:* Was a review offered? ☐1 Yes ☐2 No

6. How long do you plan to keep this annuity?

☐1 1–3 years ☐2 4–7 years ☐3 8–10 years ☐4 More than 10 years

7. Do you have any suggestions about how we could improve service to you — or any additional comments?

____

____

Date completed ____________________

Form A0463-2

Customer Assurance Program • LIMRA International

CAP

Filed electronically with SEC on 9/9/08

Comments of the Maryland Insurance Administration on Proposed SEC Rules 151A and 12h-7

Executive Summary

The Maryland Insurance Administration ("MIA") submits these comments to the Securities and Exchange Commission (the "Commission") on proposed Commission Rules 151A and 12h-7. The MIA respectfully urges the Commission not to adopt these rules.

The proposed rules are based on two premises. The first premise is that indexed annuities are securities; the second premise is that state insurance authorities do not adequately regulate indexed annuities. Both of these premises are false. Because indexed annuities operate like insurance, not securities, the Commission's historic position that they are properly subject to state insurance regulation, not federal securities regulation, is correct. Further, because indexed annuities are insurance products, the MIA, as a state insurance regulator, regulates them. The MIA's counterparts in other states do likewise.

The regulatory gap which the Commission's new rules propose to fill does not exist. These proposed rules are classic examples of a solution in search of a problem. Moreover, the Commission's proposal to add a new layer of unneeded and duplicative federal regulation will add burdens, increase costs, create confusion, and not increase consumer protection.

1. Indexed annuities are insurance products, not securities.

The Commission has not regulated indexed annuities in the past and, instead, has recognized, pursuant to section 3(a)(8) of the Securities Act of 1933, that their regulation properly lies with state insurance regulators. Section 3(a)(8) exempts annuity contracts, as well as other insurance products, from federal securities regulation when they are issued by a corporation subject to state insurance regulation. An examination of how indexed annuities operate confirms that these products are, as the Commission has viewed them for many years, exempt from the Commission's regulation as insurance products. Evidence that equity indexed annuities are insurance products, not securities, includes the following:

- The account value of an equity indexed annuity is held in the insurer's general fund. The account value in an equity indexed annuity is not invested in equities.

- The insurer on an equity indexed annuity contract guarantees a minimum rate of interest which will be credited to the account value and guarantees indexed interest pursuant to a contractual formula irrespective of the performance of the insurer's asserts; therefore, the insurer, not the policyholder, bears the market risk on the insurer's assets that the rate of return may be lower than the guaranteed rate of interest.

- The insurer can limit the amount of interest which will be credited to an equity indexed annuity by reducing the "participation rate" (in advance only) and/or by stating a maximum rate which will be credited.[1] Thus, there is no pass-through of investment performance.

- The interest that may be credited to the equity indexed annuity account value at a rate more than the rate guaranteed in the contract is similar to the "excess interest" that may be credited to a traditional deferred annuity or a universal life insurance contract and to the dividends which are traditionally expected on a whole life insurance contract.

In sum, the Commission's historic practice of not regulating indexed annuities is correct because it is the view consistent with the fact that indexed annuities are insurance products, not securities, and are exempt under section 3(a)(8). The Commission should not change its historic position.

2. The MIA regulates indexed annuities.

A. Maryland's statutory and regulatory framework

Given that indexed annuities operate as insurance products, they have been (and are) regulated – and extensively so –as insurance products. The MIA regulates the insurers that underwrite these products; the MIA regulates the producers who sell these products; and the MIA regulates the products themselves.

[1] The interest to be credited to an equity indexed annuity contract is linked to an external index, usually Standard & Poor's 500 Composite Stock Price Index. The interest is declared by the insurer at the beginning of each year and must be at least the amount required by the Annuity Nonforfeiture Law, currently between 1% and 3%. In addition, the insurer guarantees that the crediting rate will be at least a percentage of the return realized by the index (the "participation rate"). The insurer declares this participation rate in advance annually. The insurer may state a maximum rate that will be credited regardless of how the index performs.

Set forth below are the relevant Maryland statutory and regulatory citations.[2] The Maryland regulatory structure is illustrative of state insurance regulatory structures; comparable regulatory regimes exist in other states.

Regulation of insurers

- §2-201 – provides enforcement authority for violations of the Insurance Article;
- §2-205 – authorizes examination of insurers;
- §4-101 –addresses the requirements for a Certificate of Authority (including mandatory and discretionary grounds to deny, refuse to renew, suspend and revoke authority);
- §4-205 –lists "acts of insurance" which may not be done without a license;
- §5- 101 –relates to assets, liabilities, reserves, and investments of insurers;
- §7-101 –relates to Maryland's Acquisition Disclosure and Control Act;
- §9-101 –addresses circumstances where an insurer may become impaired (solvency).

Regulation of producers

- §2-206 - examination of agents;
- §10-103 - requires a license for insurance sales;
- §10-105, §10-107, §10-109, §10-116, and §10-117, requirements for an insurance license, including examinations, continuing education, and regular updating;
- §10-112 – issuance of producer license;
- §10-118 - termination with cause from carrier;
- §10-126 - permits denials, suspensions, revocations, and refusals to renew or reinstate any licensed agent;
- §12-201 - §12-210 – addresses forms of annuity products
- §27-102 - prohibits unfair trade practices;

[2] All statutory citations are to the Insurance Article of the Annotated Code of Maryland; the regulatory citations are to the Code of Maryland Regulations ("COMAR").

- §27-103 and §27-104 - permits cease and desist orders for practices/acts that are defined and for practices not expressly defined, respectively;
- §27-202 through 216 – defines "unfair and deceptive acts/practices" such as misrepresentations, false statements, boycott, coercion, intimidation, inducements, unfair discrimination, rebates, twisting, tie-in sales, and improper premiums and charges;
- §27-301 - §27-306 – prohibits unfair claim settlement practices
- §27-403 - requires return of unused premiums and prohibits false or misleading claims;
- §27-405 and §27-406 – defines unlicensed activity and unregulated insurers as fraudulent.

Regulation of product/contract

- §12-203 –addresses the requirement that forms must be submitted for approval before being sold in Maryland;
- §16-400 –addresses the required contract provisions, including grace period, incontestability, misstatement of age or sex, crediting of dividends, and reinstatement provisions;
- §16-500 - the Maryland Standard Nonforfeiture Law for Individual Deferred Annuities;
- COMAR 31.09.09 – Maryland Illustrations regulation
- COMAR 31.15.01 – Addresses Unfair Trade Practices in advertising;
- COMAR 31.15.04 – Addresses Unfair Trade Practices in solicitation of annuity contracts;
- COMAR 31.09.12 – entitled "Suitability in Annuity Transactions" is Maryland's broadly protective suitability regulation, setting forth standards and procedures for each recommendation to a consumer that results in a transaction involving an annuity product so that the insurance needs and financial objectives of the consumer at the time of the transaction are appropriately addressed. This regulation applies to insurers, agencies, and producers with respect to all annuity transactions and specifically incorporates the National Association of Securities Dealers (a/k/a Financial Industry Regulation Authority) Conduct Rules pertaining to suitability for the recommendation of variable annuities.

The Commission should take particular note of Maryland's suitability regulation (COMAR 31.09.12). By its terms, this regulation "applies to each recommendation to purchase or exchange an annuity made to a consumer by an insurance producer, or an insurer where no insurance producer is involved, that results in the purchase or exchange recommended." The regulation imposes explicit duties on insurers and producers to "have reasonable grounds for believing that the recommendation is suitable for the consumer. . . ."

The Maryland regulatory regime is as robust as it is comprehensive. Maryland's insurance regulatory structure demonstrates that any assertion that states do not currently regulate indexed annuities is false.

B. MIA staff devoted to regulating indexed annuities

Maryland's regulatory regime is not a "paper tiger." The laws on paper are backed up by substantial resources devoted to the enforcement of these laws. For example, the MIA has competent professional staff who specialize in annuity marketing; others who specialize in life insurance and annuity complaints; examiners who are qualified to examine equity indexed annuity activities; analysts who review annuity filings; staff who conduct examinations and audits; and staff who perform market conduct examinations. All of these resources are available to and, as appropriate, are applied to the effective regulation of indexed annuities.

C. MIA's market conduct activities

As detailed above, the MIA has ample legal authority to oversee all aspects of the indexed annuity industry. Pursuant to these authorities, the MIA has completed in the past five years market conduct examinations of the following companies that write equity indexed annuities:

AXA Equitable Life Insurance Company
F & G Life Insurance Company (now Old Financial Life Insurance Company)
Hartford Life & Annuity Company
Jackson National Life Insurance Company
New York Life Insurance Company
Prudential Life Insurance Company
Union Labor Life Insurance Company

No violations with respect to equity indexed annuities were found during these examinations.

D. The MIA receives few consumer complaints involving indexed annuities

The MIA's complaint files refute the assertion that there is a large and growing problem in the area of indexed annuities. Complaints about equity indexed annuities represent less than ½ of 1% of the complaints received by the MIA's Life and Health Unit. The MIA received a grand total of four complaints relating to indexed annuities in 2004, nine in 2005, seven in 2006, and three in

2007. So, over the four years, 2004-2007, the MIA received 23 complaints in this area. This is not evidence of a major problem.

3. The predictable and avoidable costs of duplicating state regulation.

The Commission will likely receive comments from the indexed annuity industry and others about the administrative burdens and financial costs associated with adding a new duplicative layer of federal regulation. The MIA wishes to highlight a different and, arguably, far more serious potential cost resulting from this proposed new layer of regulation.

A benefit of the present system is the certainty it provides as to where regulatory authority and responsibility for indexed annuities lies: it lies with state insurance regulators. That certainty will be lost if federal regulation is added to the mix. An inevitable downside of parallel state-federal regulatory systems will be disputes (some legitimate, some not) about whether a state rule or practice conflicts with and thus is preempted by a federal law. The industry players most in need of regulatory oversight will be creative in manufacturing these disputes.

Thus, a perverse or unintended consequence of the Commission's proposal, if it is pursued, is that it will create holes in a regulatory system that at present is seamless. This will be confusing to consumers and weaken consumer protection by allowing bad actors to argue that they are beyond the reach of state regulation.

With all due respect, it seems highly improbable that the Commission will devote the same level of resources to the protection of Maryland consumers as the MIA does now. Federal regulation in this area is, therefore, likely to hurt, not help, Maryland consumers.

4. The Commission has failed to consider adequately the views of states.

Without prior consultation with the states, the Commission issued its proposed rules and the Commission set a short comment period on this major change. While the Commission received numerous requests to extend the comment period, including a request from the Maryland Insurance Commissioner, the Commission ignored these requests. The Commission's treatment of this matter is disrespectful of the states' long-standing interests in this area of state authority. The Commission's approach is inconsistent with principles of federalism. *See* Executive Order 13132, § 3(a) (August 4, 1999) (agencies of the United States, other than independent regulatory agencies, shall, to the extent practicable, consult with state officials before any action is taken "that would limit the policymaking discretion of the States"). While the Executive Order is not binding on the Commission, its philosophy and rationale should guide how the Commission proceeds.

5. Conclusion

States, including Maryland, are regulating indexed annuities now and doing so effectively. The paucity of consumer complaints that the MIA has received is proof that there is no need for a new layer of federal regulation. Furthermore, there is reason to believe that the Commission's proposed rules, if adopted, will weaken consumer protection. And finally, the Commission has proceeded in this matter far too quickly and without allowing interested parties sufficient time to develop and to present their views. For all these reasons, the Commission should not adopt the proposed rules.

Ralph S. Tyler
Insurance Commissioner
Maryland Insurance Administration
525 St. Paul Place
Baltimore, Maryland 21202
410-468-2090
rtyler@mdinsurance.state.md.us

September 9, 2008

OLD MUTUAL.
INVEST INSURE INNOVATE

Old Mutual Financial Network

September 10, 2008

Ms. Florence E. Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

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

Dear Ms. Harmon:

Old Mutual Financial Network ("Old Mutual")[1] is pleased to have the opportunity to offer its comments in response to the request by the Securities and Exchange Commission (the "Commission" or "SEC") in Release No. 33-8933[2] (the "Proposing Release") for comments on proposed rule 151A that would define certain indexed annuities as not being "annuity contracts" or "optional annuity contracts" under Section 3(a)(8) of the Securities Act of 1933 (the "1933 Act").

Old Mutual opposes adoption of proposed rule 151A. The first section of this letter addresses our concern regarding the lack of need for the proposed rule particularly in light of state insurance disclosure and sales practice protections. The second and third sections discuss potentially significant collateral damage the rule may cause the non-indexed business of insurance arising from the breadth of the rule. The fourth section notes serious inconsistencies between the proposed rule, Section 3(a)(8), and guiding precedent. The last section outlines the proposed rule's adverse impact on consumers as they will bear the costs of the rule.

I. THE PROPOSING RELEASE DOES NOT ESTABLISH A NEED FOR FEDERAL REGULATION

The Proposing Release states "purchasers of indexed annuities have not received the benefits of federally mandated disclosure and sales practice protection,"[3] cites "complaints of abusive sales

[1] Old Mutual Financial Network ("Old Mutual") is the marketing name for the U.S. life insurance and annuity operations of Old Mutual plc. Working through its network of established insurance companies (OM Financial Life Insurance Company, OM Financial Life Insurance Company of New York), Old Mutual is headquartered in Baltimore, MD; maintains a National Sales Office in Atlanta, GA, and service centers in Nebraska and Atlanta. The companies that comprise Old Mutual deliver a diverse portfolio of annuities and life insurance products via an established group of master general agents. Products are distributed in 50 states and the District of Columbia. Old Mutual has nearly one million policyholders nationwide. As of June 30, 2008, Old Mutual had $18 billion in statutory-basis assets.

[2] *See* Indexed Annuities and Certain Other Insurance Contracts, Rel. No. 33-8933, 34-58022 (June 25, 2008).

[3] Proposing Release at 6.

practices,"[4] and states that protections provided by these contracts are "not...substantial enough."[5] Yet it fails to produce evidence of abusive sales practices, fails to acknowledge state regulation of disclosure and sales practices, and disregards state regulation of guarantees.

A. No Empirical Evidence Has Been Provided

The Proposing Release identifies consumer protection, especially protection of seniors, as one of the driving needs in support of the rule.[6] As evidence of this need the Proposing Release cites the statement of Patricia Struck, then President of the North American Securities Administrators Association ("NASAA"), at the first Senior Summit in June, 2006.[7] In her statement, Ms. Struck reports survey data NASAA obtained from its members about complaints involving indexed annuities and complaints involving variable annuities.[8] Because Ms. Struck's statement reports this information in the aggregate, and not separately for indexed annuities, these survey results effectively preclude meaningful analysis of this body of evidence by the Commission and the public. It certainly does not warrant the extrapolation of nontransparent combined results to the entire population of indexed annuity plans currently available in the U.S. retirement market place.[9] At the same time, the Proposing Release fails to mention, consider or analyze any of the consumer protection safeguards adopted by state insurance regulators to protect purchasers of the non-registered indexed annuities. In short, the SEC has failed to provide any empirical data regarding abuses related to the sale of indexed annuity contracts that would implicate a federal interest.

B. The Proposing Release Fails to Acknowledge State Regulation of Disclosure and Sales Practices

Since indexed annuity contracts were first introduced in the mid-1990s they have been uniformly regulated under the supervision of state insurance regulators and state insurance law as fixed annuity contracts. This uniform state insurance regulatory treatment of indexed annuities is significant in determining status of contracts under Section 3(a)(8) and differs from the uncertain

[4] Proposing Release at 8.

[5] Proposing Release at 26.

[6] *See* Proposing Release at 8, 15-17.

[7] *See* Proposing Release Note 25, at 16.

[8] *Id.* Ms. Struck states "The NASAA survey also found that unregistered securities, variable annuities and equity-indexed annuities are the most pervasive financial product involved in senior investment fraud. In California, 75 percent of the state's senior investment fraud cases involve unregistered securities. Cases involving variable or equity-indexed annuities were 65 percent of the caseload in Massachusetts, 60 percent of the caseload in Hawaii and Mississippi." We urge the SEC to publish the entire survey, including the survey instrument and all data gathered in the survey, to permit its review by interested parties. Details of the survey do not appear to be publicly available on NASAA's website or otherwise.

[9] Old Mutual has received fewer than 3 complaints per thousand in-force indexed annuity contracts for calendar years 2005, 2006, 2007 and through June 30, 2008.

state insurance regulatory status of the variable annuity contract noted by the U.S. Supreme Court in SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) ("VALIC").[10]

The state insurance regulatory landscape surrounding indexed annuities includes state insurance disclosure and sales practice regulation which the Proposing Release fails to consider. It also includes standard nonforfeiture laws—part of insurer solvency regulation which the Proposing Release recognizes and gives deference to in the context of proposed rule 12h-7[11]—which establish the minimum guarantees provided by indexed annuities.

1. State Regulation of Disclosure and Sales Practices Obviates the Need for Federal Regulation

In the cost/benefit analysis of the Proposing Release, the Commission states:

> Disclosures that would be required for registered indexed annuities include information about costs (such as surrender charges); the method of computing indexed return (*e.g.*, applicable index, method for determining change in index, caps, participation rates, spreads); minimum guarantees, as well as guarantees, or lack thereof, with respect to the method for computing indexed return; and benefits (lump sum, as well as annuity and death benefits). We think there are significant benefits to the disclosures provided under the federal securities laws.[12]

The Annuity Disclosure Model Regulation[13] provides disclosure standards to protect consumers and foster consumer education. The regulation specifies the minimum information which must be disclosed and the method for disclosing it. In particular, the following disclosures must be given in the form of a written disclosure statement at point of sale under Section 4 B. of the regulation:

> At a minimum, the following information shall be included in the disclosure document required to be provided under this regulation:
> (1) The generic name of the contract, the company product name, if different, and form number, and the fact that it is an annuity;
> (2) The insurer's name and address;

---

[10] The *VALIC* Court observed that state insurance regulatory treatment of the then new variable annuity was far from uniform:

> Some States deny these "annuity" contracts any status as "insurance". Others accept them under their "insurance" statutes. It is apparent that there is no uniformity in the rulings of the States on the nature of these "annuity" contracts.

359 U.S. 65, 69.

[11] Proposing Release at 47.

[12] Proposing Release at 70.

[13] NAIC 245-1. The goal of this regulation is to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts.

(3) A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate:

(a) The guaranteed, non-guaranteed and determinable elements of the contract, and their limitations, if any, and an explanation of how they operate;

(b) An explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;

(c) Periodic income options both on a guaranteed and non-guaranteed basis;

(d) Any value reductions caused by withdrawals from or surrender of the contract;

(e) How values in the contract can be accessed;

(f) The death benefit, if available and how it will be calculated;

(g) A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and

(h) Impact of any rider, such as a long-term care rider.

(4) Specific dollar amount or percentage charges and fees shall be listed with an explanation of how they apply.

(5) Information about the current guaranteed rate for new contracts that contains a clear notice that the rate is subject to change.

Finally, in addition to requiring a product-specific disclosure statement, the Annuity Disclosure Model Regulation also requires delivery of the Buyers Guide for Equity-Indexed Annuities.[14]

State insurance departments undertake an exacting review of each indexed annuity contract before the contract may be offered in the state. In connection with that review, state insurance regulators typically request very detailed information about the contract and practices regarding the offer and sale of the contract. State insurance regulators may condition the sale of a particular indexed annuity on prior regulatory review. Notably, this review generally includes a review of the product-specific disclosure statement and related materials.[15] Indexed annuity disclosure statements and related marketing materials are made to conform to applicable insurance laws in each jurisdiction where the product is sold.[16]

Disclosures the SEC finds important are being given under state insurance laws regulating disclosure and sales practices. Proposed rule 151A will result in a duplication of disclosure at

[14] For examples of this specialized state insurance regulatory disclosure for equity-indexed annuities, *see* http://www.idfpr.com/doi/life_annuities/equityindex.asp and http://www.dora.state.co.us/Insurance/regs/4-1-12%20attach.pdf.

[15] *See, e.g.,* Minnesota Department of Commerce, Checklist for Annuities, http://www.state.mn.us/mn/externalDocs/Commerce/Annuities_031103093332_lh45chk.pdf (requiring insurers provide "a copy of the disclosure statement that will accompany contracts, i.e., a form that the policyholder signs, certifying that he/she understands the key features of the contract, which features shall be addressed clearly and completely in the disclosure document").

[16] Section 9 of the Advertisements of Life Insurance and Annuities Model Regulation requires insurers maintain advertising files and requires an authorized officer to state, as part of the insurer's annual statement filed with the insurance commissioner, that advertisements disseminated by or on behalf of the insurer in the state during the preceding statement year "complied or were made to comply in all respects with the provisions of these rules and the insurance laws of this state."

the consumer's expense and without any added benefit to the consumer. We believe the Commission must take into account the nature, extent and effectiveness of state insurance disclosure and sales practice regulation both in evaluating the need for the regulatory protections of the federal securities laws and in making the required cost/benefit analysis related to proposed rule 151A. The cost/benefit analysis is deficient in that regard because the Commission has ignored state insurance laws regulating disclosure and sales practices.

In addition to the Annuity Disclosure Model Regulation, the growing body of state insurance disclosure and sales practice regulation we believe the Commission should consider in this rulemaking proceeding include the following:

- The Suitability in Annuity Transactions Model Regulation[17]
- The Insurance and Annuity Replacement Model Regulation[18]
- The Advertisements of Life Insurance And Annuities Model Regulation[19]
- State "free look" requirements[20]
- State oversight and approval of products and related product disclosure, including the work of the Interstate Insurance Product Regulation Commission[21]
- State insurance unfair trade practice law and regulation[22]

---

[17] Initially adopted by the National Association of Insurance Commissioners ("NAIC") in 2003 as the Senior Protection in Annuity Transactions Model Regulation, this regulation now applies without regard to the age of the purchaser. It establishes standards and procedures for recommendations to consumers in connection with annuity transactions. These standards insure that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed. In particular, Section 6 B. requires the insurance producer (or the insurer if no producer is involved) to make reasonable efforts to obtain information regarding the purchaser's financial and tax status, investment objectives and other information used or considered to be reasonable in making recommendations to the consumer.

[18] The purpose of this regulation is to regulate the activities of insurers and producers with respect to the replacement of existing life insurance and annuities by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions. The regulation assures that purchasers receive the information needed to make an informed purchase decision.

[19] This regulation establishes minimum standards and guidelines to assure a full and truthful disclosure to the public of all material and relevant information in the advertising of life insurance policies and annuity contracts.

[20] *See* Md. Code Ann. Ins. § 16-105(2008)(requiring notice prominently printed on the face of the annuity contract informing owner of right to cancel policy within 10 days of delivery). The Buyers Guide for Indexed Annuities calls attention to this right as follows: "When you receive your contract, read it carefully. It may offer a "free look" period for you to decide if you want to keep the contract. Ask your agent or insurance company for an explanation of anything you don't understand. If you have a specific complaint or can't get the answers you need from your agent or company, contact your state insurance department."

[21] *See* note 15 *supra* and Interstate Insurance Product Regulation Commission, Rule Establishing Uniform Standards for Index-Linked Interest Crediting Features for Deferred Non-Variable Annuity Products (May, 2008) http://www.insurancecompact.org/rulemaking_records/080530_index_linked_crediting.pdf.

[22] *See e.g.*, Md. Code Ann. Ins. § 27-102(prohibiting unfair trade practices); Md. Code Ann. Ins. § 27-202—216 (defining unfair and deceptive acts and practices);COMAR 31.15.01(unfair trade practices in advertising);COMAR 31.15.04 (unfair trade practices in solicitation of annuity contracts).

- State insurance department market conduct examinations[23]
- Enforcement actions by state insurance regulators and state attorneys general[24]

Proponents of proposed rule 151A may argue that the Commission should ignore various model regulations or laws noted above for the Commission's review which have not been promulgated or enacted in every jurisdiction. In this regard, the Commission should consider that insurers doing business throughout the United States routinely develop one disclosure form for each product and then use it in all jurisdictions where they conduct business, including jurisdictions that have not yet adopted particular NAIC model laws or regulations. The Commission followed a similar path when it set the specified rate of interest under Rule 151(b).[25]

The Commission's Division of Investment Management previously observed that Justice Brennan "in declaring that state insurance law did not provide adequate protection to an investor in a mutual fund...*appeared to focus on the absence of disclosure requirements in state law*".[26] The world of insurance disclosure and sales practice regulation has evolved considerably since VALIC was decided on March 23, 1959. Today there is "no absence of disclosure requirements in state law" applicable to indexed annuity contracts. We urge the Commission to consider state insurance disclosure and sales practice protections.[27]

2. State Regulation of Minimum Values

Indexed annuities include important guarantees of principal and credited interest under state insurance solvency regulation designed to protect contractowners that did not apply to the

---

[23] *See, e.g.*, Vermont Department of Insurance
http://www.bishca.state.vt.us/InsurDiv/market_conduct_exams/a_marketconduct_reports2.htm

Missouri Department of Insurance, Financial Institutions and Professional Registrations
http://insurance.mo.gov/cgi-bin/MCExamsList.pl

[24] *See, e.g*, Pennsylvania Department of Insurance, Enforcement Actions, Michael J. Kman, Jr., Docket No. CO 00-01-002 (March 3, 2000)(Respondent sold three index annuity products and misrepresented to his clients that there would not be a surrender charge if their contracts were surrendered prior to maturity. After the sale, Respondent asserts he became aware of the surrender charge. The clients requested their annuity contracts be rescinded and the full amount of their deposits be refunded, which the insurer did. Respondent has been placed under a two year period of license supervision). http://www.ins.state.pa.us/ins/cwp/view.asp?a=1276&q=528650&pp=3

[25] Under Rule 151(b) the Commission tied the minimum rate required to be credited to the relevant nonforfeiture law in the jurisdiction in which the contract is issued, or, if the jurisdiction had not adopted such law, or no longer mandated that a minimum rate apply to existing contracts, then "the specified rate under the contract must at least be equal to the minimum rate then required for individual annuity contracts by the NAIC Standard Nonforfeiture Law." *See* Definition of Annuity Contracts or Optional Annuity Contracts, Rel. No. 33-6645 (May 29, 1986)(Adopting Release at 7)(hereinafter referred to as "Release 6645").

[26] Division of Investment Management, United States Securities and Exchange Commission, Protecting Investors: A Half Century of Investment Company Management, 393 at note 84 (May, 1992)(hereinafter referred to as "Protecting Investors")(emphasis added).

[27] We also urge the Commission to consider that in contrast to the well developed state regulation of disclosure applicable to indexed annuities, neither the proposed rule nor the Commission's Form S-1include any disclosure standards specific to indexed annuities. Moreover, there is no office of the SEC charged with regulating these products. By contrast to state insurance regulators, the SEC has no experience whatsoever regulating indexed annuity contracts.

variable annuity considered by the Supreme Court in SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) ("United Benefit").

In particular, state insurance nonforfeiture laws[28] set a floor for benefit payments by establishing the interest rate used to calculate these benefits and the minimum amount of the initial and subsequent purchase payments to which this rate must apply. Nonforfeiture laws were initially enacted to protect purchasers of insurance contracts—not to protect the insurance companies issuing the insurance contracts,[29] although they clearly play a supporting role in regulating insurer solvency today.[30]

In contrast to United Benefit's Flexible Fund annuity, purchase payments under indexed annuities are insurer general account—not variable separate account—assets. The purchaser of an indexed annuity does not participate in the investment experience of the insurer's general account. This fact is significant because state insurance nonforfeiture laws protect purchasers of general account deferred annuities, including indexed annuities, before annuity payments begin.[31] State insurance nonforfeiture laws *do not* protect purchasers of variable annuities[32] who

[28] State nonforfeiture laws generally trace their origins to public outrage over tontine policies sold in the United States from the time of the Civil War until the early 1900s, when they were outlawed as a result of legislation adopted in New York in 1906. This legislation resulted from a recommendation of the Armstrong Committee investigations of the insurance industry in New York in 1905.

Under a tontine policy, a dividend was paid only if the insured survived the time period specified in the contract. In its report the Armstrong Committee noted that the three largest New York insurers at that time "sold mostly tontine policies on which dividends had fallen far short of the estimates made for policyholders at the time of purchase." George A. Norris, Voices from the Field – A History of the National Association of Life Underwriters (National Association of Life Underwriters, 1989).

"Tontine insurance held certain appeals. The policyholder was offered the possibility of munificent returns on his investment if he adhered to his contractual agreement. Management, on the other hand, accumulated large amounts of capital since, unlike annual-dividend insurance, it did not have to disperse yearly payments. Furthermore, since the company did not pay a cash surrender value on tontine policies, lapsed money was not returned. This amount proved sizable; a twenty-five percent or higher lapse rate was common." H. Roger Grant, Insurance Reform Consumer *Action in the Progressive* Era, 7 (The Iowa State University Press, 1979).

[29] See Alfred N. Guertin, *Developments in Standard Non-Forfeiture and Valuation Legislation,* Journal of the American Association of University Teachers of Insurance, Vol. 13, No. 1, 5-15 (Mar. 1946) (Discussing post-Armstrong investigation legislative initiatives, Guertin states at 7: "The conference of Governors, Attorneys General and Commissioners and its Committee of Fifteen was dealing with disclosures developed by [the Armstrong] investigation. *It was not an emergency involving the solvency of companies, however.* It is understandable, therefore, that their report did not contain recommendations on the matter of reserves from the standpoint of solvency of companies. *They were interested in the practices of companies in their relation to policyholders.*")(Emphasis added).

[30] *See, i.e.*, Report of the American Academy of Actuaries' Annuity Nonforfeiture Section 6 Work Group on Section 6 of the NAIC Model Standard Nonforfeiture Law for Individual Deferred Annuities (Boston, June, 2005), https://www.actuary.org/pdf/life/nonforfeit_6_june05.pdf (standard nonforfeiture law addresses insurer solvency, equity between surrendering and continuing policyholders and "smoothness", i.e., to gradually eliminate any difference between the cash surrender value of the surrendering policyholder and the paid up annuity value of the continuing policyholder as the policy approached maturity).

[31] *See, i.e.,* Md. Code Ann. Ins. § 16-501(7) (2008).

[32] *See, i.e.,* Md. Code Ann. Ins. § 16-501(4) (2008).

assume ("underwrite") the risk that the surrender value of the variable annuity will be less than what they paid for it, and therefore receive the alternative protections of the federal securities laws which focus on disclosure in lieu of a state regulated guarantee of principal.

Importantly, the minimum guaranteed surrender values in *general account* indexed annuities are determined through state legislative processes regulating the business of insurance rather than being determined at the insurer's discretion. The guaranteed surrender values in Old Mutual's *general account* indexed annuities are determined in accordance with state insurance nonforfeiture laws which provide significantly stronger guarantees than the one considered and rejected by the Supreme Court in United Benefit.

Like all other deferred annuity contracts, indexed annuity contracts credit interest during the accumulation period.[33] The amount of interest an insurer is obligated to credit under a deferred indexed annuity contract is determined under the most favorable to the contract owner of two outcomes: (1) by a formula set forth in the contract which takes into account changes in a commercially published index of securities; or, (2) according to an annual minimum guaranteed rate of interest determined under state insurance nonforfeiture laws.

One state regulatory advocacy group seeking jurisdiction over indexed annuities blatantly ignores applicable state insurance law when it claims that guarantees under indexed annuities are "established by insurers in their discretion, usually at very low rates."[34] In fact, minimum guarantees under these non-registered contracts are established by the Standard Nonforfeiture Law for Individual Deferred Annuities adopted through legislative process in 47 states and the District of Columbia.[35] These state insurance solvency laws protect purchasers of *general account* indexed annuities against the risk of "insignificant" guarantees like the one included in the *separate account* variable annuity examined by the Supreme Court in United Benefit.

In considering the issue of what constitutes an adequate guarantee of principal under an indexed annuity contract, the Commission should take into account that under state insurance solvency laws, insurers offering these contracts are not legally required to provide cash surrender values prior to maturity.[36] However, most insurers include a provision that allows for a lump sum settlement at maturity or at any other time before annuity payments begin.

When insurers include cash surrender and partial withdrawal rights in their indexed annuities, state nonforfeiture laws strike a balance between contractowners who hold their contracts until benefits begin and contractowners who elect to "cash out" before annuity payments begin. Long term insurance contracts are not demand deposit accounts; there is a significant cost to insurers

---

[33] The Proposing Release at 9 states "During the accumulation period, the insurer credits the purchaser with a **return** that is based on changes in a securities index…." The insurer credits interest under an indexing formula; it does not pass through a "return."

[34] NASAA's Briefing Paper in Support of the SEC's Proposed Rule on Equity Indexed Annuities, p. 1 (August 11, 2008).

[35] The Van Elsen Report, http://www.veconsulting.com/resources/idanlmap.pdf (August 30, 2005).

[36] *See, i.e.,* Md. Code Ann., Ins. § 16-503 (2008).

ND: 4826-5782-8354

who provide the right to surrender a long term contract on any day.[37] Nevertheless, purchasers who elect to "cash out" of these contracts receive—at a minimum—the guaranteed cash value mandated under state nonforfeiture law.

The Commission noted in Release 6645 it had received a substantial number of comments requesting that it clarify proposed language in Rule 151(b)(2)(i) to avoid any appearance of favoring front-end loaded contracts over those that incorporate contingent deferred sales charges or defray sales and other expenses through a charge against contract value. In response to these comments, the Commission modified the rule slightly to adopt the substance of the suggested revisions. In doing so, the Commission noted that "the rule does not discriminate against contracts that do not have front-end charge structures."[38]

Few states specifically cap commission rates; for those that don't, state insurance nonforfeiture laws implicitly cap sales charges by requiring minimum cash surrender values in all indexed annuities that provide cash surrender values. In other words, no matter what the commission rate is on the contract, in a non-variable, non-registered fixed account indexed annuity, the insurer can never utilize a contingent deferred sales charge (surrender charge) that causes the value payable to the owner of the contract to fall below the minimum guaranteed amount under state insurance nonforfeiture laws.

The Proposing Release notes that under current state nonforfeiture laws, indexed annuities typically provide that the guaranteed minimum value is equal to at least 87.5% of purchase payments, accumulated at an annual interest rate of between 1% and 3%.[39] The Proposing Release further notes that, assuming application of the lowest state authorized guarantee of 87.5% of the premium accumulated at the lowest possible rate of one percent, it will take approximately 13 years for a purchaser's guaranteed minimum value to equal 100% of the purchase payments.[40] The SEC's current view that state insurance nonforfeiture guarantees are not "substantial enough"[41] stands in marked contrast to the favorable views previously expressed by its Division of Investment Management on the significant protections provided by state insurance nonforfeiture and reserve laws.

The Division of Investment Management in the context of recommending that the Commission propose amendments to the Investment Company Act to exempt variable insurance contracts from the charge restrictions in sections 26 and 27, instead requiring that charges under these contracts be reasonable in the aggregate, noted the comparable role played by state insurance nonforfeiture laws:

---

[37] *See, e.g.*, TIAA-CREF's analysis of why it cannot afford to waive restrictions in its Traditional Annuity which does not provide lump-sum cash withdrawal benefits, and instead only allows participants to withdraw their funds from the Traditional Annuity in 10 annual installments. TIAA-CREF Traditional Annuity Contract 2007 Legislation – Optional Retirement Program (2008) www.unf.edu/dept/humanres/articles/tiaa_cref_orp.pdf.

[38] *See* Release 6645 at 6.

[39] *See* Proposing Release at 13.

[40] *Id.*

[41] Proposing Release at 26.

> State insurance law, particularly its nonforfeiture provisions, is designed to achieve objectives that are similar to the restrictions of sections 26 and 27. Like section 27(d) of the Investment Company Act, nonforfeiture law protects contract owners from paying excessive charges by limiting an insurer's deduction when an owner voluntarily surrenders his or her contract. In deciding what is appropriate for an insurer to retain, state officials, through the nonforfeiture requirements, attempt to balance the extent to which an insurer has not recovered the expenses incurred in issuing the contract and the extent to which the surrendering contract owner has prepaid for services for which he or she will never receive. Because selling costs are usually a key component of unamortized expenses, nonforfeiture law, like section 27(d), helps to limit the amount of these expenses an insurer may keep.
>
> Less directly, state reserve requirements, like sections 26 and 27 of the Investment Company Act, also protect a contract owner from paying excessive charges for contract services. The reserve requirements achieve this aim in two important respects: (1) by requiring that mortality costs be determined in accordance with prescribed mortality tables; and (2) by requiring that prepaid premiums or cash value be credited with a minimum rate of interest. While reserve requirements do not affect directly the amount of expenses that may be deducted under a contract, they generally assure the maintenance of minimum values so that guaranteed benefits can be provided.[42]

While numerous commenters have attacked commissions paid by some insurers as excessive, and the Commission has offered its view that minimum cash surrender values are not adequate ("we do not believe these protections are substantial enough"),[43] Congress has not yet repealed the McCarran-Ferguson Act and nothing in VALIC or United Benefit empowers the Commission to substitute its judgment for the applicable state legislature's determination of what "fraction of the benefits will be payable in fixed amounts" under fixed annuity contracts. One indexed annuity referenced in the Proposing Release[44] that is currently registered with the Commission offers sales commissions of up to 15%. Yet, to our knowledge, FINRA has not proposed a rule for registered indexed annuities similar to its Conduct Rule 2830 which prohibits FINRA members from offering investment company shares when aggregate sales charges exceed a certain level specified in the rule.

II. THE PROPOSED RULE IS OVERLY BROAD ON ITS FACE

The Commission states in the Proposing Release that its proposed rule 151A "is intended to clarify the status under the federal securities laws of indexed annuities."[45] Contrary to the stated intent, proposed rule 151A *on its face*[46] does not limit the scope of its application to the

[42] See Protecting Investors at 411-412.

[43] *See* Proposing Release at note 51 and accompanying text.

[44] *See* Proposing Release at note 17.

[45] Proposing Release at 5.

[46] *See* Proposing Release at 93-94.

regulation of certain indexed annuities. Instead, proposed rule 151A potentially sweeps within its ambit most of the general account life insurance and annuity contract business of U.S. life insurers. Proposed rule 151A, if adopted in its current form, effectively repeals or significantly amends Section 3(a)(8) in the absence of Congressional action to do so.

A. The Overbroad Scope of Rule 151A Would Lead to Uncertainty in Interpretation And Application of the Rule

All life insurance company general account products with cash values must credit current interest or determine values above guaranteed values by reference to performance of general account investments. Insurers must invest purchase payments they receive for general account indexed annuities in accordance with state insurance solvency laws regulating permitted investments. Importantly, these laws do not distinguish insurance company general account investments by type of product. Instead, these state insurance laws apply to the entire reserve an insurer is required to maintain for all general account products it sells. Depending on the products an insurer offers, this may include life, health and disability insurance as well as annuities.

For example, OM Financial Life Insurance Company, domiciled in Maryland, must comply with Maryland Insurance Code § 5-511(a-1) when it invests purchase payments it receives under its indexed annuities. This statute provides:

> Each life insurer shall have and continually maintain an amount equal to its entire reserves, as required by this article, in any combination of the types of assets authorized by subsections (c) through (p) of this section subject to the limit, if any, set for each type or class of investment.

OM Financial Life Insurance Company must also comply with the cited statute when it invests the premiums it receives for its general account life insurance policies as well as when it invests the purchase payments it receives for its traditional fixed annuities.

The assets permitted under the quoted insurance regulatory law include various types of securities as defined in Section 2(a)(1) of the Securities Act. OM Financial Life Insurance Company accordingly holds various securities, as defined in Section 2(a)(1) of the Securities Act as part of its statutory general account reserves as mandated by Maryland insurance law.

At a minimum, OM Financial Life Insurance Company of necessity must calculate amounts it will actually pay under each of its general account annuities and life insurance policies having a cash value—not just its indexed annuities—in whole or in part, by reference to the performance of a security, including a group or index of securities it holds as part of its statutory reserves for these contracts, thus satisfying the first part of the new test in Proposed Rule 151A(a)(1).

Depending on how broadly the Commission or a court subsequently interprets "amounts payable" in proposed Rule 151A(a)(1), the proposed rule may reach a variety of other contracts, such as long term care insurance policies that have cash values. This test may also extend to features of contracts that do not have cash values, but have current pricing elements that deliver "performance" that is better than the guaranteed maximum pricing, for example, current non-guaranteed premiums on indeterminate premium term life insurance policies.[47]

B. Indexed Annuity Contracts Fall Within the Section 3(a)(8) Exemption

The text of Section 3(a)(8) does not support the test set forth in proposed rule 151A(a)(1). Section 3(a)(8) exempts from the registration requirements of the 1933 Act:

> Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.

Indexed annuities are annuity contracts issued by insurance corporations that are subject to the supervision of state insurance regulators. This supervision includes traditional solvency regulation as well as state insurance disclosure and sales practice regulation. This supervision has been continuous since indexed annuities were first introduced in the mid-1990's.

In VALIC, the Court observed its:

> reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements. When the States speak in the field of 'insurance,' they speak with the authority of a long tradition. For the regulation of 'insurance' though within the ambit of federal power [citation omitted], has traditionally been under the control of the States.[48]

Indexed annuities are annuities within the plain meaning of the statute. Congress has not acted to repeal this statute. Similarly, Congress has not acted to repeal the McCarran-Ferguson Act under which Congress left the business of regulating insurance to the states. As discussed above, the states have uniformly regarded indexed annuities as part of the business of insurance since they were first introduced in the mid-1990's and have regulated these contracts as traditional deferred annuity contracts are regulated under those laws—laws that are "in actual effect." In proposing rule 151A, the SEC takes a position inherently inconsistent with the U.S. Supreme Court's reluctance in VALIC "to disturb the state regulatory schemes that are in actual effect." In doing so the SEC proposes a rule so broad that it effectively repeals Section 3(a)(8) for an ill-defined class of contracts much broader than indexed annuities.

---

[47] In an indeterminate premium term policy, the premium may fluctuate between the current charge and a maximum amount stated in the insurer's premium tables, which are based on the insurer's mortality experience, expenses, and investment returns. See http://www.finweb.com/insurance/types-of-term-policies.html

[48] 359 U.S. 65, 68-69.

III. THE TEST IN PROPOSED RULE 151A(A)(2) IS OVERLY BROAD AND MEANINGLESS WHEN ONLY ONE OUTCOME IS POSSIBLE

Since any general account product that credits interest over and above guaranteed minimums must necessarily do so by reference to the performance of securities held as part of the insurer's general account reserves, nearly every product that is subject to the test will be a security. In fact, it is difficult to conceive of any saleable product that potentially credits excess interest that would not be a security. As such, the "test" is not a pass-fail test. It is a fail-only test. As a practical matter, a test with only one outcome is a meaningless test and could just as easily be restated as "any product that potentially credits nonguaranteed interest is a security."

IV. THE TEST IN PROPOSED RULE 151A(A)(2) IS CONTRARY TO AND INCONSISTENT WITH SECTION 3(A)(8) AND GUIDING PRECEDENT CITED IN THE PROPOSING RELEASE

Proposed rule 151A incorporates a new test that is neither derived from nor supported by Section 3(a)(8) or the U.S. Supreme Court decisions interpreting the scope of Section 3(a)(8) cited in the Proposing Release. Stated differently, the new test—which essentially defines investment risk as the risk the contractowner will receive less excess indexed interest than hoped for over and above the minimum guaranteed rate of interest established by the applicable state nonforfeiture law—is contrary to Section 3(a)(8) and guiding precedent cited in the Proposing Release. The new test completely ignores the fact that indexed annuities protect contractowners against the *very* risks implicating the need for federal securities law protections in VALIC and United Benefit.

A. Proposed Rule 151A Fails to Evaluate State Regulated Guarantees

1. VALIC

In VALIC, the Supreme Court held that the variable annuity at issue was not an "annuity" within the meaning of Section 3(a)(8) because the entire investment risk was borne by the annuitant, not the insurance company. The variable annuity guaranteed "nothing to the annuitant except an interest in a portfolio of common stocks or other equities—an interest that has a ceiling but no floor."[49]

The key investment characteristic that caused the annuity at issue in VALIC to fall outside the scope of Section 3(a)(8) was that the insurer provided *no* guarantee of principal and interest. The Supreme Court contrasted the variable annuity at issue in VALIC with traditional insurance contracts, noting that the "common understanding of "insurance" involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts."[50] The Court also noted that "companies that issue these [general account] annuities take the risk of failure"[51] because an

[49] 359 U.S. 65, 72.

[50] 359 U.S. 65, 71.

[51] *Id.*

ND: 4826-5782-8354

insurer may not obtain a large enough return on the premiums it invests to meet its contractual guarantees.

Unlike the variable annuity contract examined by the Supreme Court in VALIC, insurers issuing non-registered indexed annuities today provide at least the guaranteed minimum values required by state nonforfeiture laws.[52] Thus, unlike a variable annuity, which contains no guarantee of principal and interest or guaranteed minimum values, there is always an insurance guarantee present in indexed annuities that "at least some fraction of the benefits will be payable in fixed amounts." Indexed annuities have a significant floor which is established by state legislatures in regulating the business of insurance.

Old Mutual's indexed annuities are not variable annuities. The annuitant has no interest in a portfolio of common stocks or other equities. The value and benefits offered under Old Mutual's indexed annuities are independent of the investment experience of the insurance company's general account. Assets supporting Old Mutual's obligations under its indexed annuities are part of the insurance company general account—not a variable separate account—and as part of its statutory reserve, do not support any other general account liability to any greater or lesser extent.

In particular, Old Mutual's indexed annuities provide the following guarantees:

- The guarantee of principal and all previously credited interest;

---

[52] Indexed annuities comply with the same state standard nonforfeiture law that traditional fixed annuities comply with, as contrasted to registered indexed annuities that comply with a modified guaranteed annuity state regulation (contracts with certain market value adjustment ("MVA") features) or variable annuities that pass the actual investment experience of a separate account through to contract holders and which are not subject to a state standard nonforfeiture law.

To paraphrase VALIC, state legislatures in regulating the business of insurance adopt nonforfeiture laws that determine "what fraction of the benefits will be payable in fixed amounts" under indexed annuity contracts. The Proposing Release recognizes the protection that state insurance law provides in regulating the financial condition of *insurers* in the context of proposed rule 12h-7. It fails to appropriately consider the equally important protection that state insurance law provides to *purchasers* of indexed deferred annuities—including those who choose for whatever reason to surrender their contracts while a surrender charge remains applicable.

From a product perspective, state insurance law addresses *insurer* solvency through a variety of laws including but not limited to:

- valuation laws which regulate reserves an insurer must hold by type of contract
- investment laws which specify permitted investments and investment concentration for general account products; and,
- risk-based capital requirements.

Obviously, these laws intended to protect insurer solvency indirectly protect *purchasers* of contracts by facilitating the likelihood that the insurer will be able to pay its contractual obligations when due. However, **state insurance law also directly protects *purchasers* by requiring insurers to provide certain minimum benefits to persons who surrender these contracts.** *See* Black and Skipper, Life & Health Insurance, 13th Ed. p. 754-756. "Concepts of Equity" (2000).

- The guarantee that an index credit will never be less than zero, in other words, there will be no negative interest;
- Guaranteed surrender charges that do not vary with the investment performance of the insurer's general account;
- Guaranteed surrender charges that do not vary with changes in market interest rates, in other words, Old Mutual's indexed annuities do not include MVA features of any kind;[53]
- Guaranteed surrender charges that do not reduce the surrender value below the minimum permitted values under state insurance nonforfeiture laws regulating the business of insurance;
- Guaranteed surrender charges that are fixed percentages established at contract issue and are contingent solely on when a surrender or early annuitization occurs during the surrender charge period;
- Guaranteed surrender charges that are unrelated to any change in the underlying indexes referenced by the interest crediting formulas in the contract;
- Guaranteed surrender values that are computed using a "specified rate of interest" as defined in Rule 151 and will always equal or exceed the minimum nonforfeiture amount required under state nonforfeiture laws regulating the business of insurance;
- A guaranteed death benefit before annuity payouts begin, paid without the assessment of surrender charges which might otherwise be lawfully imposed under state nonforfeiture laws regulating the business of insurance; and,
- Guaranteed annuity purchase rates on annuity payout options which include life contingent payments, which are established at contract issue and may not be changed by the insurer when longevity improves.

In contrast to the SEC's position that the guarantees provided by indexed annuities are not "substantial enough," these state regulated insurance guarantees assumed by the insurance company place all the investment risk on the insurance company and none on the annuitant. The insurance "companies that issue these annuities take the risk of failure."[54]

---

[53] The cost to an insurer of foregoing an MVA has been estimated to be as much as 100 basis points annually:

"The 'two-tiered annuity,' where one interest rate is available to those policyholders who surrender in a lump sum, whereas a higher rate is available to those who receive their benefit in the form of an annuitization over several years, was developed to reward policyowners who do not subject the insurer to the "cost" of book value surrender. However, critics of this form of annuity argue that those who surrender in a lump sum are receiving an amount that is unfairly low, and that the buyer of such policies might be forced into receiving this lower value by an unexpected emergency.
While this criticism appears to have merit, it ignores the difference in costs to the insurer, which can be measured as the price of the option granted to the policyowner to receive the lump sum value without adjustment for market value losses of the assets backing such annuity. Such an option mandates that the insurer must invest portions of the funds received in shorter duration securities than it would invest in if such an option were not present. This option has been priced by some studies that indicate this "cost" to be as much as 100 basis points annually."
NAIC Proceedings 1993, Vol. IB, p. 1429

[54] 359 U.S. 65, 71.

2. **United Benefit**

In United Benefit, the Supreme Court held that the variable annuity at issue was not an "annuity" within the meaning of Section 3(a)(8) because the insurer promised "to serve as an investment agency and allow the policyholder to share in its investment experience" and while the insurer provided a guaranteed surrender value, it was "insignificant."

In United Benefit, the Supreme Court analyzed a variable annuity under which the insurer invested the net premiums through a *separate account* established under Nebraska insurance law,[55] primarily in common stocks[56] and the contract owner bore the investment risk. In United Benefit the annuity at issue fell outside the scope of Section 3(a)(8) because the guarantee of principal was not meaningful.

At any time before maturity, the insurer provided a guaranteed surrender value under the contract equal to the greater of:

- her proportionate share of the fund; or
- a cash surrender value equal initially to 50% of net premiums in the first five years, increasing to 100% of net premiums after 10 years.[57]

Notably, United Benefit was not obligated to offer *any* guarantee in its variable annuity. Accordingly, under the Nebraska state insurance regulatory scheme governing insurance company *separate account* products, United Benefit was free to set the terms of the guarantee in its favor rather than the contract owner's under most economic scenarios.[58]

---

[55] Following the VALIC decision in 1959, state legislatures adopted laws authorizing life insurance companies to: (1) issue variable annuities; and, (2) establish separate accounts. A variable separate account is an asset account maintained independently from the insurer's general investment account and is used primarily for retirement plans and variable products. This arrangement permits wider latitude in the choice of investments, particularly in equities. 2007 Life Insurers Fact Book, *supra*, note 18.

Section 2(a)(14) of the 1933 Act defines separate account as "an account established and maintained by an insurance company pursuant to the laws of any State or territory of the United States, the District of Columbia, or of Canada or any province thereof, under which income, gains and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company."

Purchase payments for a *general account* indexed annuity are not held in a variable separate account. The purchaser of an annuity issued by a variable separate account participates in the investment gains and losses of the separate account. In contrast, the assets of the general account belong to the insurance company. General account assets are used by the insurance company in support of the business it conducts, including the payment of guaranteed obligations it has assumed under the terms of the general account indexed annuities it issues. *The purchaser of a general account indexed annuity does not participate in the gains or losses of the general account of an insurer.*

[56] 387 U.S. 202, 205.

[57] *Id.*

[58] The record in United Benefit showed 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 become operable under any prior conditions." 387 U.S. 202, 209.

The "guaranteed surrender value" in United Benefit's variable annuity was not required by law; rather, it was apparently added to United Benefit's variable annuity in an attempt to satisfy the assumption of investment risk requirement that the Supreme Court found lacking in VALIC.

B. Proposed Rule 151A Fails to Evaluate Investment Risk Assumed by the Insurer

Insurers issuing fixed annuities (both traditional and indexed) assume a variety of investment risks including:

- the risk that they will have insufficient funds to meet all contractual obligations.
- the risk of disintermediation. This is the risk that interest rates will rise and contract owners will exercise their right to surrender the contracts. To pay these surrender values, the insurer must sell assets, primarily bonds, from its general account at depressed market values, in which case the insurer may incur substantial losses well in excess of any surrender charges the insurer may collect. Some insurers have addressed this risk by shifting it to the contract owner through a registered MVA feature; Old Mutual's indexed annuities do not include any MVA features, and Old Mutual retains one hundred percent of the disintermediation risk under its indexed annuities.
- reinvestment risk. This is the risk that as bonds in the insurer's general account mature or coupons are paid, available bond returns are reduced to a level that will not support the guarantees embedded in the contract including the guarantees dictated by state nonforfeiture laws.

In addition to these risks, insurers issuing fixed indexed annuities face a variety of other investment risks related to the strategies they employ to hedge the risks they assume when they agree to pay interest based in part on changes in an external index they neither control nor manage:

- counterparty or credit risk. This is the risk that the hedge asset purchased to fund the indexed crediting strategy may not return the required amount needed to credit the contractually agreed upon rate of interest due to default of the issuing party. If this occurs, the insurer must still pay the calculated rate of interest due under the contract from its general account assets.
- the risk that the hedge program will return less than the amount needed to credit the contractually agreed upon rate of interest. This occurs frequently as insurers must make assumptions concerning persistency (how many contract owners will keep their contracts rather than surrender them) and strategy allocations (how contract owners may choose to allocate their contract value among various interest crediting options available under the contract)—with the timing of each of these events being determined solely by the contract owner without regard to, or knowledge of, the insurer's general account assets which support its contractual obligations.

In each case, regardless of the results of any hedge strategy the insurer may employ, the insurer must credit interest as determined in accordance with the interest crediting formula in the contract. Under no circumstance may the insurer credit a lesser amount of interest because the insurer's hedge strategy failed to produce the funds necessary to honor the insurer's contractual obligation. The insurer alone bears this risk.

The Proposing Release omits any discussion of these investment risks insurers assume when they issue indexed annuity contracts. Instead, proposed rule 151A's new test equates "investment risk" with indexed interest credited on the initial investment that exceeds the minimum guaranteed rate of interest established by the applicable state nonforfeiture law. This risk is not the type of investment risk the U.S. Supreme Court in VALIC defined as relevant in Section 3(a)(8) analysis.

C. Proposed Rule 151A Adopts an Incorrect Measure of Investment Risk

The Proposing Release indicates annuity owners assume the investment risk under the contract when they are "more likely than not to receive payments that vary in accordance with the performance of a security."[59] Under proposed rule 151A(a)(2), this investment risk is present when "amounts payable" are more likely than not to exceed "amounts guaranteed."[60]

Proposed Rule 151A(a)(2) equates amounts of current interest[61] to be received by the contract owner under the terms of the index-linked interest crediting formula to investment risk assumed by the owner of an indexed annuity. But the risk of what the current interest rate will be is not an investment risk of the type indicative of a non-exempt security under Section 3(a)(8). It is fundamental to the business of insurance and exists in all contracts in which the insurer indicates it will (or may) credit a current interest rate that exceeds the state mandated minimum guaranteed rate of interest established by state legislatures in regulating the business of insurance.

The Proposing Release indicates the consumer "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."[62] This statement confuses the uncertainty of not knowing what current interest rates the insurer will declare in the future with underwriting of investment risk. In every traditional fixed annuity the consumer bears the risk that the insurance company may not declare a current interest rate that exceeds the state mandated minimum guaranteed rate of interest.

The difference between "amounts payable" and "amounts guaranteed" is simply a measure of excess interest declared by an insurance company, not investment risk.[63] Historically, crediting

[59] Proposing Release at 5.

[60] Proposed Rule 151A(a)(2).

[61] Note that the "more likely" standard indicates that *more* current interest indicates more consumer risk, which is inconsistent with the solvency point of view that the *obligation to* pay more current interest indicates more insurer risk.

[62] Proposing Release at 6.

[63] Under Subsection (b)(1) of Proposed Rule 151A surrender charges would also be included in this difference. Insofar as the Proposed Rule intends to deem a contract a security if it charges a contingent deferred sales charge, we would consider this preemptive of state regulation of insurance which establishes minimum contract surrender values for fixed annuities and therefore imposes maximum permissible surrender charges. In any event, we disagree in concept with a rule dictating when charges should be taken into account. If amounts payable at a point in time or

of excess interest has been indicative of insurance company risk taking, not risk taking by the annuity owner. Once a current interest rate is declared the insurance company is obligated to credit contract values at that interest rate regardless of whether its general account assets perform consistently with the declared rate of current interest.

The Rule 151 Proposing Release[64] distinguished the *frequency* of crediting of current interest from the *amount* of current interest to be credited and noted that the amount to be credited, although indicative of the amount of risk the insurer bears, is a solvency risk adequately addressed by state insurance regulation:

> Of course, the degree of investment risk assumed by the insurer also is based on the *amount* of discretionary excess interest it guarantees. But that risk, *i.e.*, the risk that the insurer, by making imprudent investments or because of insolvency, will not be able to satisfy its contractual obligations, is the type of risk that Congress deemed to be adequately addressed by state insurance regulation. See VALIC, 359 U.S. at 77 (emphasis added).[65]

Similarly, to the extent any purchaser of an indexed annuity bears a risk of insurer insolvency there is adequate state regulation. The Proposing Release acknowledges in connection with the proposal of Rule 12h-7 that solvency risks are adequately addressed by state regulation: "[I]nvestors who purchase these securities are primarily affected by issues relating to the insurer's financial ability to satisfy its contractual obligations—issues that are addressed by state law and regulation."[66]

D. Proposed Rule 151A Disregards Marketing as a Factor under Section 3(a)(8) And Therefore Is Inconsistent With Supreme Court And Other Judicial Precedent

The Proposing Release acknowledges that "marketing is another significant factor in determining whether a state-regulated insurance contract is entitled to the Securities Act 'annuity contract' exemption" [67] and cites the applicable language from United Benefit.[68] The Proposing Release further states that the Commission analyzes "indexed annuities under the facts and circumstances factors articulated by the U.S. Supreme Court in VALIC and United Benefit."[69] However, the Proposing Release fails to analyze the marketing of indexed annuities. Further, proposed rule

---

upon happening of an event (surrender) are net of charges then charges should be taken into account, and if amounts guaranteed at a point in time or upon happening of an event (death) are not net of charges then charges should not be taken into account.

[64] Definition of 'Annuity Contract or Optional Annuity Contract', Rel. No. 33-6558 (Nov. 21, 1984)(proposing Rule 151).

[65] *Id.* at Note 18.

[66] Proposing Release at 7.

[67] Proposing Release at 19.

[68] *Id.*

[69] Proposing Release at 23.

151A does not incorporate a requirement that the class of contracts to be denied the exemption must, in accordance with United Benefit, be "marketed in a manner that appeals to the purchaser not on the usual basis of stability and security but on the prospect of 'growth' through sound investment management." The omission of this factor from proposed rule 151A is startling given the emphasis the Proposing Release places on abusive sales practices.

In United Benefit the Supreme Court first articulated the "marketing test" for purposes of determining which contracts meet the requirements of Section 3(a)(8). The Supreme Court based its conclusion in part on the manner in which the variable annuities were advertised. The Supreme Court noted that United Benefit's annuity, and others like it, were *not* promoted "on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management."[70] Such contracts were marketed to compete with mutual funds and were "pitched to the same consumer interest in growth through professionally managed investment."[71]

The obligation not to market an indexed annuity primarily as an investment, however, does not preclude an insurer from discussing what may be considered to be the investment aspects of the contract. In Associates in Adolescent Psychiatry v. Home Life Insurance Company, the federal district court 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.[72] 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 company'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."[73]

This finding of the Home Life court was reiterated in the decision of the federal district court in Berent v. Kemper Corp.[74] In finding that the life insurance policies in question were marketed primarily as insurance, the court determined that "the facts that the sales brochures also discuss the investment features of the policies and that Plaintiffs...perceived the policies as investment

---

[70] 387 U.S. 202.

[71] *Id.*

[72] 729 F. Supp 1162 (N.D. Ill., 1989); *aff'd*, 941 F.2d 561 (7th Cir.1991), *cert denied*, 502 U.S. 1099 (1992).

[73] *Id.* at 1174 (emphasis added).

[74] 780 F. Supp. 431 (E.D. Mich. 1991); *aff'd*, 973 F. 2d 1291 (6th Cir. 1992).

vehicles does not change...the conclusion that the...policies were not marketed primarily as investments."[75]

More recently, the federal district court in Malone v. Addison Insurance Marketing, Inc.,[76] applying the United Benefit marketing test, 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]aking 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 Contract 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.[77]

The court concluded that the contract was exempt from the federal securities laws under Section 3(a)(8).[78]

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 necessarily 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 accurately describes both the insurance and investment features of a particular contract, and that emphasizes the product's

---

[75] *Id.* at 443.

[76] 225 F. Supp. 2d 743 (W.D. Ky, 2002).

[77] *Id.* at 753-754.

[78] The Proposing Release is critical of Malone's findings under Rule 151 but it does not criticize the court's ruling under Section 3(a)(8).

usefulness as a long-term insurance device for retirement or income security purposes, would undoubtedly 'pass' the rule's marketing test."[79]

Old Mutual controls the content of its indexed annuity marketing materials to comport with these standards and the standards applicable to the advertising of these contracts under state insurance law. By not considering marketing as a factor, the proposed rule is inconsistent with Supreme Court and other judicial precedent.

E. Proposed Rule 151A Disregards Mortality Risks as a Factor under Section 3(a)(8)

Both judicial[80] and Commission interpretations recognize that mortality risk is an important consideration in determining whether annuity contracts come within the Section 3(a)(8) exclusion. In a general statement of policy issued on April 5, 1979, the Commission identified the assumption of mortality risks and investment risks as central features of life insurance or annuity contracts.[81] In the release adopting Rule 151, however, the Commission withdrew Release 6051 and abandoned this requirement for purposes of the safe harbor. Nevertheless, the Commission continued to express the view that mortality risk may be an appropriate factor to consider determining the availability of an exemption from Section 3(a)(8).[82]

Old Mutual's indexed annuities provide a death benefit before annuity payouts begin. This death benefit is significant in that interest is calculated under the indexing formula until the death benefit is calculated. This contrasts with the general contract surrender value under which no indexed interest is credited to amounts surrendered during an indexing period.

In addition, although not required to do so under applicable state nonforfeiture law, when Old Mutual pays the death benefit under an indexed annuity, it waives any remaining surrender charge. Because Old Mutual waives surrender charges when it pays a death benefit under its indexed annuities, the value of the death benefit may be even greater to seniors than it is to younger retirement savers. In any event, Old Mutual assumes a significant traditional insurance mortality risk in providing this benefit that proposed rule 151A fails to consider.

In addition to assuming the mortality risks associated with the death benefit Old Mutual provides under its indexed annuities, Old Mutual assumes other significant mortality risks under its

---

[79] Release 6645 at 13.

[80] Grainger v. State Security Life Insurance Co., 547 F.2d 303, 307 (5th Cir. 1977)(considering the relationship between the size of the death benefit and the size of premium payments as part of the court's Section 3(a)(8) analysis), reh'g. denied, 563 F.2d 215 (5th Cir. 1977), cert. denied sub nom. Nimmo v. Grainger, 436 U.S. 932 (1978); Dryden v. Sun Life Assurance Co. of Canada, 737 F. Supp. 1058 (S.D. Ind. 1989)(concluding that the insurer's obligation to pay a fixed sum to a designated beneficiary upon the death of the owner of a life insurance policy caused the insurer to bear the risk of poor performance of its investments).

[81] Statement of Policy Regarding the Determination of the Status Under the Federal Securities Laws of Certain Contracts Issued by Insurance Companies, Rel. No. 33-6051 (Apr. 5, 1979)(hereinafter referred to as "Release 6051").

[82] *See, e.g.*, Brief for the United States as Amicus Curiae at 9, Variable Annuity Life Insurance Co. v. Otto, No 87-600 (1988).

indexed annuities in connection with annuity payment options it provides based on life contingencies. By currently guaranteeing life annuity options that can be selected at some future time, Old Mutual assumes a mortality risk that the longevity of its annuitants may be greater than it assumed when it issued the contract.

V. PROPOSED RULE 151A WILL HAVE THE UNINTENDED CONSEQUENCE OF REDUCING LONG TERM VALUE TO CONSUMERS INTERESTED IN GUARANTEED GENERAL ACCOUNT PRODUCTS

About 77 million baby boomers are expected to retire over the next few years. Many of these retirees will not have a source of guaranteed monthly income for their lifetime apart from Social Security benefits. A recent study commissioned by Americans for Secure Retirement, a coalition of more than 50 organizations representing women's, small business, agricultural, Hispanic and African American groups concluded that retirees would be much better prepared if they had a guaranteed source of retirement income beyond Social Security.[83]

Annuities are insurance contracts that pay a steady stream of income for either a fixed period of time or for the lifetime of the annuity owner, in addition to providing a number of other important guarantees. Because they guarantee a stream of income for life, annuities protect senior consumers against the real and growing possibility of outliving their financial resources due to factors such as increased longevity, rising health care costs, declining investment markets and reductions in Social Security benefits.

Consumers saving for retirement benefit when they have a variety of registered and non-registered products from which to choose. Consumers who have selected indexed annuities over variable annuities, mutual funds or other securities for some portion of their retirement savings have generally done so to obtain stable income, a guarantee of principal and interest that has been credited to the contract, and the other guarantees that indexed annuities provide.

A. Additional Costs of Issuing Registered Products will Be Passed Through to Consumers

Insurance companies issuing registered indexed annuities will incur additional one-time and permanent additional costs. Many of these costs are noted in the Proposing Release, such as costs of performing the required test, cost of registering products,[84] cost of printing prospectuses and mailing them to investors, costs of life insurance agents entering into networking arrangements with broker-dealers, and loss of revenue.

---

[83] Nancy Treos, "Many Retirees Face Prospect of Outliving Savings, Study Says" The Washington Post, July 13, 2008.

[84] The Proposing Release estimates aggregate annual costs of $82,500,000 assuming 400 contracts each year will be filed on Form S-1. This works out to a per contract cost of $206,500 for preparing and filing registration statements for indexed annuities. Using this figure, it will cost Old Mutual in excess of $4,500,000 to file the 22 indexed annuities it currently offers. This figure does not include prospectus print and mailing costs or the cost of hiring independent actuarial consultants to develop or validate the company's testing procedures.

Costs not noted may include:

- costs related to due diligence undertaken by professionals and required in connection with the preparation and filing of a registration statement on Form S-1;[85]
- costs to design, develop and maintain new recordkeeping systems required in connection with registered products;[86]
- costs of destroying existing inventories of marketing materials;
- costs of preparing and filing new advertising materials[87] with FINRA;
- costs of administering registered products in excess of the costs of administering non-registered products;
- costs related to increased audit expenses, including the need to inform independent auditors about the companies' controls, procedures and assumptions related to its registered contract business operations;
- costs to build or modify systems due to direct requirements of the proposed rule (e.g., to provide prospectuses and confirms) or indirect consequences of the proposed rule (e.g., possible product design revisions);
- costs associated with negotiating and preparing selling agreements between the insurance company, its principal underwriter and registered broker-dealers;[88]
- costs associated with staffing reductions including in some cases, costs of compliance with "plant closing" laws for insurers downsizing or exiting altogether;
- costs of staffing additions and staffing replacements as new needs are determined, for example, adding wholesalers by firms that do not currently distribute their product through broker-dealers;
- costs arising from increased litigation expense and professional witness fees; and
- costs attributable to increased insurance and bonding expense.

These costs would necessarily be passed through to the consumer in the form of lower guarantees, lower credited interest rates, higher surrender charges, higher optional feature charges or other product design modifications. Additional costs to the consumer will necessarily

[85] The Proposing Release at 76 mentions only the costs of preparing and reviewing disclosure; it does not address the costs of professional due diligence examination required in connection with the preparation of a registration statement on Form S-1.

[86] The Proposing Release at 76 mentions only the cost of retaining records. For companies that do not currently issue registered contracts these costs may be significant.

[87] Note, however, in the absence the SEC's adoption of a rule for indexed annuities comparable to Rule 482, the SEC adversely and unfairly burdens the marketing of indexed annuities vis-a-vis variable annuities and mutual funds.

[88] This cost will be greater for insurers who currently lack a variable contract or mutual fund distribution platform. The Proposing Release at 75 and 77-78 mentions only the cost of entering into networking agreements which applies to distributors, not insurers.

result in lower long term retirement value to consumers which is not a desirable outcome given the current retirement crisis in America.

B. Proposed Rule 151A Will Have the Effect of Decreasing Competition and/or Product Availability

Because indexed annuities are currently regulated as insurance, the Commission is well aware of the fact that insurance agents unaffiliated with broker-dealers are the primary distributors of indexed annuities today. We expect some of these insurance licensed only providers will become affiliated with broker-dealers as an associated person. We expect far more will not do so. Purchasers of indexed annuities currently can choose among providers: the purchaser can select an insurance licensed only provider, or may choose an insurance licensed provider who is also an associated person of a registered broker-dealer. Proposed rule 151A will eliminate the first choice entirely.

In view of the costs associated with registered products, we expect some insurers will simply stop selling these contracts altogether, and as a result, will lose significant revenues. In some cases, if an insurer can not find other revenue sources, it may need to merge with another company or cease doing business altogether.

On the other hand, insurers who choose to offer non-registered contracts following adoption of Rule 151A will need to design their contracts so that the indexing formula more often than not returns no more than the applicable state nonforfeiture guaranteed rate of interest. Insurers offering such contracts may find that those contracts are uncompetitive with other alternative long term savings vehicles in many, if not most, interest rate environments.

The effect of the adoption of Rule 151A clearly will be to reduce consumer choice and increase the costs of owning an indexed annuity contract.

C. Registration of Products Will Have the Effect of Reducing Guarantees In Products and/or Transferring Greater Investment Risk to Consumers

Indexed annuities already registered with the Commission,[89] because of the MVA feature contained in these contracts, may not guarantee minimum interest rates or may provide guaranteed minimum values that are less than what those values would be if they were computed under the standard nonforfeiture laws applicable to indexed annuities.[90]

In view of the significant cost to insurers of providing the guarantees required by the standard nonforfeiture law for individual deferred annuities applicable to indexed annuities, we believe it is reasonable to conclude that some insurers will simply file the product with the Commission as a separate account variable annuity on Form N-4, utilizing index funds as the underlying

[89] *See* Proposing Release at Note 17 and accompanying text.

[90] Nonforfeiture values for annuities with MVA features are not determined under the standard nonforfeiture law for individual deferred annuities that applies to indexed annuities; rather, nonforfeiture values for MVA contracts are set under a separate regulation.

investment option, and by doing so, eliminate the requirement to provide any of the guarantees now found in non-registered indexed annuities.

Other insurers may find ways to shift additional risk to the purchaser of a registered indexed annuity. For example, rather than guarantee no negative interest, perhaps an insurer will guarantee that no more than 1% negative interest will be credited during the applicable crediting period. Other insurers may reduce the interest crediting period from at least 12 months to something less.

The clear result would appear to be that the costs of owning an indexed annuity contract would increase.

* * *

Old Mutual appreciates the opportunity to provide comments on this proposal. In accordance with the Proposing Release at 2, we are filing this paper comment in triplicate with the Commission's Acting Secretary. On August 1, 2008, Old Mutual filed a formal request with the Commission in this rulemaking proceeding to extend the comment period to January 8, 2009 to permit its company management to ascertain the precise impact of the proposal. We believe the proposed rule deserves more analysis than the current comment period has permitted, especially since it potentially requires registration with the Commission of a number of insurance products offered today by insurers that do not offer indexed annuities and who are likely unaware of the need to analyze the impact of the proposed rule on their contracts. In any event, we respectfully reserve the right to supplement our comments herein with the Commission should it elect to extend the comment period. If you have any questions about our comments or would like any additional information, please contact me at (410) 895-0082.

Sincerely,

Eric Marhoun
Senior Vice President & General Counsel

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

Andrew J. Donohue, Director, Division of Investment Management
Susan Nash, Associate Director, Division of Investment Management
William J. Kotapish, Associate Director, Division of Investment Management
Keith E. Carpenter, Special Counsel, Division of Investment Management
Michael L. Kosoff, Attorney, Division of Investment Management

GIBSON, DUNN & CRUTCHER LLP

LAWYERS

A REGISTERED LIMITED LIABILITY PARTNERSHIP
INCLUDING PROFESSIONAL CORPORATIONS

1050 Connecticut Avenue, N.W. Washington, D.C. 20036-5306
(202) 955-8500
www.gibsondunn.com

EScalia@gibsondunn.com

September 10, 2008

Direct Dial
(202) 955-8206

Fax No.
(202) 530-9606

Client No.
04928-00001

VIA COURIER

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

Re: *Comment on Proposed Rule 151A*
Release Number 33-8933 (File Number S7-14-08)

Dear Ms. Harmon:

On behalf of the Coalition for Indexed Products, I am submitting the enclosed comments regarding the Securities and Exchange Commission's Proposed Rule 151A, which was published for comment on July 1, 2008.

Respectfully submitted,

Eugene Scalia /DJD

Eugene Scalia

ES/djd

Comments

of the

Coalition for Indexed Products

Regarding Proposed Rule 151A

Release Number 33-8933 (File Number S7-14-08)

September 10, 2008

TABLE OF CONTENTS

Page

Comments
of the
Coalition for Indexed Products
Regarding Proposed Rule 151A

The Coalition for Indexed Products (the "Coalition") hereby provides these comments on Proposed Rule 151A under the Securities Act of 1933 (the "Proposed Rule"). The Coalition comprises most of the largest fixed indexed annuity issuers, who together accounted for more than $17 billion in fixed indexed annuity sales in 2007. The Coalition is vitally interested in the Proposed Rule and welcomes this opportunity to comment.[1]

The Proposed Rule is profoundly flawed and the Coalition respectfully submits that the proposal should be withdrawn and that the Commission should affirm that fixed indexed annuities—as characteristically structured and offered by insurers today—are not securities within the meaning of the securities laws. As proposed, the rule would narrow the exclusion for annuity contracts in the Securities Act of 1933 (the "Act" or "'33 Act") in a way that is inconsistent with the plain text of the Act and the decisions of the courts. In place of the multi-factored consideration developed by the Supreme Court and previously endorsed by the Commission, the Proposed Rule would install a test that is centered upon a novel and groundless definition of "investment risk" and that ignores other important factors identified by the Court.

Properly understood, fixed indexed annuities are in fact annuities within the meaning of Section 3(a)(8) of the '33 Act, and the Commission's proposal to regulate them as securities manifests a misunderstanding both of these products and of the extensive state regulatory system for the oversight of all fixed annuity contracts. Because fixed indexed annuities already are thoroughly regulated by the states as Congress intended, the Commission also errs in claiming significant regulatory benefits for its proposal and is incorrect in claiming that the proposal will further efficiency, competition, and capital formation. In truth, the benefits claimed by the Commission already are realized through state regulation. The Proposed Rule would only impose an additional, unnecessary layer of conflicting regulatory requirements that would needlessly increase costs and drive from the market a substantial portion of the salesforce that insurers and consumers rely upon for the delivery of fixed indexed annuities. As it raises the

---

[1] The Coalition's member companies are Allianz Life Insurance Company of North America, American Equity Investment Life Insurance Company, Aviva Life and Annuity Company, Conseco Insurance Company, EquiTrust Life Insurance Company, Life Insurance Company of the Southwest (a National Life Group company), Midland National Life Insurance Company, National Western Life Insurance Company, North American Company for Life and Health Insurance, OM Financial Life Insurance Company (an Old Mutual company), and OM Financial Life Insurance Company of New York.

costs paid by senior citizens and others for these popular products, the Proposed Rule would also restrict competition and the products available to consumers and would impose a burden that falls particularly hard on the small businessmen and women who are integral to the sale of annuities and other insurance products.

For these reasons and the reasons set forth at length below, the Coalition asks that the Commission withdraw its Proposed Rule and affirm that fixed indexed annuities as described below are annuity contracts that fall outside the Commission's regulatory authority.[2]

I. Factual Background: Fixed Indexed Annuities And Proposed Rule 151A.

A. Fixed Indexed Annuities.

Fixed Indexed Annuities ("FIAs") are annuity contracts under which purchasers receive a credit based upon the performance of one or more equity or bond indices, such as the S&P 500 Composite Stock Price Index or the Lehman Brothers Bond Index. Interest credited to an FIA contract is periodically "locked in" (typically on an annual basis) so that previously earned interest credits—like the principal itself—are protected against future decline in value.

The additional, index-based interest component of the contract gives the purchaser the opportunity to have his policy credited with a potentially higher interest rate than might be credited on traditional fixed-rate products—historically, FIA interest credits have averaged 1 to 2 percent higher than comparable fixed rates.[3] In years that the index declines, the purchaser receives no indexed interest, but all previously credited interest and premium payments are unaffected. The index-based component thus provides the purchaser the opportunity for higher indexed interest in years that the index rises, while protecting against index declines. Holders of fixed indexed annuities have experienced no reduction in contract values at any point during the volatile markets of recent years.

---

[2] The Coalition previously requested an extension of the comment period for 90 days in order to fully respond to the issues raised in the Proposing Release. *See* Comment of the Coalition for Indexed Products (Aug. 19, 2008). The Coalition again emphasizes that, given more time, it could develop a fuller analysis of the Proposed Rule and provide a more complete response to the significant issues presented by the Proposing Release.

[3] *See Assocs. in Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 941 F.2d 561, 565 (7th Cir. 1991) (Easterbrook, J.) ("*AIAP*") (noting that traditional fixed annuities typically "carry relatively low (implicit) rates of return even in an inflation-free economy, because underwriters cannot readily hedge against changes in the economy-wide rate of return"). *See also* September 10, 2008, Statement of Mark Meyer, Ph.D., at 7 (attached as Addendum hereto) ("[T]he average annual credits will have an appreciably higher value than for the comparable fixed-rate annuity due to the typical historic characteristic of equity index increases exceeding the risk-free rate that is embedded in option pricing.").

The formula for calculating the amount of the indexed interest is generally reset annually in advance and includes a method to measure the change in the index, the percentage of the change allowed (the "participation rate"), and a minimum interest credit (the "floor") which is never less than zero. Upper-end "caps" are often applied to the amount of index-related credits for a given year—a 6 percent annual "cap" or 3 percent monthly cap, for example, would constitute the maximum amount credited that year or month for index-related gains. Features such as caps, participation rates, asset fees, spreads, and floors all have the effect of defining and moderating the impact of market factors by placing pre-determined upper and lower limits on the amount of the contract's index-related credits.

A critical feature of FIAs is the applicability of minimum nonforfeiture laws. These laws—which apply to fixed rate annuities also, but not to variable products—require FIAs to have a guaranteed minimum contract value even after any costs and charges are taken into account. Thus, after taking into account possible withdrawal charges discussed below, the contract value must be equal to at least 87.5 percent of initial premiums carried forward with interest at a rate of between 1 and 3 percent per year, depending on a legally-prescribed interest rate benchmark.[4]

Fixed indexed annuities generally also include liquidity options and mortality features. The liquidity options typically include (i) annual penalty-free withdrawals of up to 10 percent of the value of the contract; (ii) the ability to annuitize and receive a stream of payments for life and/or a specified period (these annuitization options frequently can be exercised before the end of the withdrawal charge period without the imposition of any withdrawal charge); (iii) a nursing home rider which permits increased withdrawals of a specified percentage of the contract value if the policyholder enters a nursing home; (iv) a terminal illness rider which permits a withdrawal of some or all of the contract value if the policyholder is terminally ill; and (v) for those fixed indexed annuities sold in qualified markets—such as Section 403(b), eligible governmental 457, and other 401(a) markets—policy loans may be issued up to statutory and/or plan limits.

Two mortality features are common in FIAs. Generally, upon the death of the policyholder (or annuitant), the full contract value is paid to the named beneficiaries without deduction of withdrawal charges. Policyholders may also sometimes annuitize their full contract value, without deduction of withdrawal charges, at any time after the first contract year for a period based on life expectancy.

When an FIA is sold, no sales charge is typically assessed. Instead, sales commissions are paid from the insurance company's general assets, allowing 100 percent of the premium paid

---

[4] The minimum annual rate of interest is the lesser of (i) 3 percent per year or (ii) the five-year Constant Maturity Treasury Rate reported by the Federal Reserve, reduced by 1.25 to 2.25 percent but not less than 1 percent. *See* NAIC Standard Nonforfeiture Law. This guaranteed minimum nonforfeiture value applies only at surrender of the annuity contract; it does not establish a minimum policy value or cash value.

to be applied to the contract. In addition, minimum nonforfeiture laws guarantee that a contract owner will receive no less than 87.5 percent of premiums plus a minimum annual rate of interest even if the contract is surrendered in the first year, regardless of any otherwise applicable withdrawal charge. As reflected in the table attached hereto as Exhibit A, the guarantees in index products are comparable to those in traditional fixed-rate annuities.[5]

Unlike premiums from variable annuities, 100 percent of premiums from indexed annuities and other fixed annuities are deposited in the insurer's "general account" and, after deductions for expenses related to the sale of the annuity, invested in the general account. Indexed and other fixed annuity premiums are not placed in a segregated account as is the case of a variable annuity. A typical insurer's general account is invested in "permitted investments" as specified by state law, and consists primarily of high-quality fixed income securities, U.S. and government agency bonds, and other high-quality permitted assets.[6] The insurer bears the risk that changing interest rates and credit conditions will affect the value of the assets in its general account. Poor performance of the assets in the insurer's general account may require the insurer to reduce shareholders' equity to satisfy its obligations to policyholders. The insurer thus bears a wide variety of significant risks, including credit risk, prepayment and extension risk, interest rate risk, asset/liability matching risk, and hedging risk.

The insurer is required by state insurance laws to maintain prescribed levels of capital to support the risks of its business. Even higher capital levels may be required by rating agencies. The level of reserves the insurer maintains for its annuity liabilities is also governed by state insurance laws. Capital and reserve requirements for FIAs are calculated in a substantially identical manner to the calculation for traditional fixed annuities. Purchasers of FIAs are further protected by comprehensive "guaranty fund" laws similar to FDIC insurance. State insurance laws generally provide guarantee fund coverage of at least $100,000 per contract owner (in the event of the insurance company's insolvency) that is similar to the coverage for traditional fixed annuities, and substantially different from the coverage for traditional variable annuities.

---

[5] As the Commission notes, some FIAs have been registered when there is an "absence of any guaranteed interest rate or the absence of a guaranteed minimum value." *See* Indexed Annuities and Certain Other Insurance Contracts, Securities Act Release Nos. 33-8933, 34-58022, 73 Fed. Reg. 37,752, 37,754 n.17 (July 1, 2008) [hereinafter Proposing Release]. In this comment, we address FIAs as characteristically structured and offered by insurers today, namely, products that (1) meet state minimum nonforfeiture requirements; (2) declare participation rates, caps, and spreads a year in advance; (3) do not credit negative interest; and (4) "lock in" credited interest against future declines in value.

[6] A small portion of FIA premiums are not invested in typical general account bond investment assets but are invested in options and other similar types of vehicles to hedge against applicable market movements. Pursuant to most state laws, insurance companies in their general accounts are permitted to "hedge" but not "speculate." The insurance company—not the purchaser—assumes the potentially significant risks related to hedging, including changes in value and counterparty performance.

Companies that offer fixed indexed annuities generally adhere to advertising rules—some of which are prescribed by state law—that limit the ways in which fixed indexed annuities are marketed. For example, a variety of terms are prohibited that might confuse the customer as to the type of product being sold. The practice of Coalition members and the prevailing practice in the industry is to emphasize the safety and stability of the products, as well as the fact that FIAs are not investments in or alternatives to the stock market. Guaranteed minimum interest rates must be disclosed, and other similar features that protect against a reduction in value and provide long-term retirement security are also disclosed. The products are presented as long-term savings vehicles.

Except for the operation of the index interest crediting component of the product, the essential elements of fixed indexed annuities are identical to traditional fixed annuities. Unlike variable annuities and mutual funds, fixed indexed annuities do not credit "negative returns" to contract value. Also unlike variable annuities and mutual funds, fixed indexed annuities provide a guaranteed minimum nonforfeiture value. Fixed indexed annuities are subject to permitted investment laws, higher capital requirements, and guaranty fund coverage; variable annuities are not. All annuity products typically require a purchaser to pay fees for administrative costs or to agree to remain in the annuity contract for a certain period of time, with penalties—sometimes called surrender or withdrawal charges—for prematurely removing funds in excess of the amounts that are allowed by the many liquidity features noted above. It should go without saying that withdrawal charges—which are generally included in annuity contracts to cover the costs of premature withdrawals that impair the economic expectations on which the contract was based—are not a basis to distinguish fixed indexed annuities from other fixed annuities which share the same feature under close supervision of state law. *See also Assocs. in Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 941 F.2d 561, 567 (7th Cir. 1991) (Easterbrook, J.) ("*AIAP*") (stating withdrawal charges do "nothing to throw *investment* risk on the investor") (emphasis in original).

As discussed more fully at pages 20-27 below, states have a comprehensive regulatory system for fixed indexed annuities and other fixed annuity products, elements of which include mandatory disclosure of product terms; contract "readability"; evaluation of "suitability" of the product for the purchaser; monitoring of marketing; and authority to investigate complaints and institute enforcement actions regarding improper practices. Indeed, even as the Commission proposes to regulate fixed indexed annuities *as securities*, it has encouraged state regulation of the products *as annuities* and relies upon that regulation to this day.

B. The Proposed Rule.

Proposed Rule 151A would define a class of annuities that would be deemed ***not*** to be an annuity or optional annuity within the meaning of Section 3(a)(8) of the '33 Act. The Proposed Rule has two prongs. The first determines whether the product is within the bounds of the rule at all by inquiring whether the annuity is "indexed" in some fashion; the second prong then applies a purportedly closer analysis to determine whether the product is indeed *not* an annuity for purposes of Section 3(a)(8). Specifically, under Proposed Rule 151A an annuity would be a security if:

(1) Amounts payable by the issuer under the contract are calculated, in whole or in part, by reference to the performance of a security, including a group or index of securities;[7] and
(2) Amounts payable by the issuer under the contract are more likely than not to exceed the amounts guaranteed under the contract.

Indexed Annuities and Certain Other Insurance Contracts, Securities Act Release Nos. 33-8933, 34-58022, 73 Fed. Reg. 37,752, 37,774 (July 1, 2008) [hereinafter Proposing Release]. The second prong purportedly accounts for investment risk borne by the purchaser. The status under the '33 Act of annuities that fall outside the definition (*i.e.*, are not "not an annuity") "would continue to be determined by reference to the investment risk and marketing tests articulated in existing case law under Section 3(a)(8) and, to the extent applicable, the Commission's safe harbor rule 151." Proposing Release at 37,762.

II. Fixed Indexed Annuities Are Annuity Contracts Within The Meaning Of Section 3(a)(8).

Section 3(a)(8) of the '33 Act excludes from the Act any annuity contract (or optional annuity contract) issued by an insurance company subject to the supervision of a state insurance commissioner (or similar entity or official).[8] The plain meaning and purpose of the Act, Supreme Court precedent, and lower court decisions all make clear that fixed indexed annuities as characteristically structured are covered by Section 3(a)(8) and are exempt from regulation by the Commission. The Commission should acknowledge this and withdraw its Proposed Rule.

A. Fixed Indexed Annuities Are Annuity Contracts Within The Plain Meaning Of The Statute.

Application of Section 3(a)(8) begins with the plain meaning of the words in the statute. *BedRoc Ltd., LLC v. United States*, 541 U.S. 176, 183 (2004). In relevant part, Section 3(a)(8)

---

[7] "Security" would have the same meaning it has in Section 2(a)(1) of the '33 Act. *See* Proposing Release at 37,759.

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

> Section 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:
>
> . . .
>
> (8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia[.]

A product falling within Section 3(a)(8) is also exempt from all other provisions of the Act. *Tcherepnin v. Knight*, 389 U.S. 332, 342-43 n.30 (1967); Proposing Release at 37,755 n.27.

excludes "[a]ny insurance or endowment policy or annuity contract or optional annuity contract" from the Securities Act. Two things are notable about this language: First, if a contract is an annuity (and is issued by a corporation regulated by a state insurance commission or the like), it is exempt from SEC regulation. Section 3(a)(8) is not an invitation for the Commission to speculate about the *types* of annuities that Congress might have wished the SEC to regulate and those left for the states. And the Commission's view of the "regulatory and protective purposes" (Proposing Release at 37,757; citation omitted) of the securities laws will not suffice to regulate an instrument otherwise properly regarded as an annuity, not a security.

Second, the text of Section 3(a)(8) separately refers to insurance policies *and* annuity contracts—the two are not the same, and the Commission may not predicate a rule on the assumption that annuities must display *all* the characteristics of life insurance, for instance, and none that are associated with investments. "[C]ontracts of life insurance and of annuity are distinctly different," 1 J. Appleman & Appleman, *Insurance Law and Practice*, § 84, at 295 (1981), and in some respects "[a]nnuity contracts must . . . be recognized as investments rather than insurance." *Nationsbank of N.C. v. VALIC*, 513 U.S. 251, 259 (1995) (quoting Applebaum & Applebaum); Proposing Release at 37,757 n.42 (recognizing annuities as a "form of investment"). Thus, to show that a product entails elements of the "'investment experience'" (Proposing Release at 37,758; citation omitted) is merely to show that it possesses characteristics of an annuity, which are excluded under Section 3(a)(8). That fixed indexed annuities, like all annuities, display some investment characteristics not found in life insurance contracts is hardly a basis to conclude that they are securities that may be regulated by the Commission.[9]

It is notable as well that fixed indexed annuities are regulated thoroughly by the states, which recognize them as annuities, not securities. *See* Buyer's Guide To Fixed Deferred Annuities With Appendix For Equity-Indexed Annuities, National Association of Insurance Commissioners, at 6 (attached as Exhibit B): "When you buy an equity-indexed annuity you own an insurance contract. You are not buying share of any stock or index." *And see* Comment

---

[9] The Proposing Release quotes out of context Justice Brennan's reference to "the investment experience" in his concurring opinion in *SEC v. Variable Annuity Life Insurance Co. of America*, 359 U.S. 65, 77-78 (1959) (Brennan, J., concurring). Justice Brennan referred in full to a stockholder being "a *sharer* in the investment experience *of the company*" that solicited her investment—literally, a shareholder. *Id.* at 77 (emphases added). In such a case, "the coin of the company's obligation is not money but is rather the present condition *of its investment portfolio*." *Id.* at 78 (emphasis added). It was this fact—not the fact of investment risk alone—that was central to Justice Brennan's conclusion that a variable annuity whose value was determined by the portfolio of the issuing company was a security. *See id.* at 78-79 ("[T]he majority of [the securities laws'] provisions are of greatest regulatory relevance . . . *where the investors . . . participate on an 'equity' basis in the investment experience of the enterprise*") (emphasis added); *id.* at 80 ("[W]here the investor is asked to put his money *in a scheme for managing it on an equity basis*, it is evident that the Federal Act's controls become vital.") (emphasis added). Even as it places inordinate reliance on this two-Justice concurring opinion, the Proposing Release quotes the opinion out of context and misses its essential point.

of the National Governors' Association (Sept. 4, 2008) ("States already regulate equity-indexed annuities as insurance products."). State regulation of the products is not dispositive, as the Supreme Court's decision in *VALIC* shows. But the Commission, like the Supreme Court, should "start with a reluctance to disturb the state regulatory systems that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements." *SEC v. Variable Annuity Life Ins. Co. of Am.*, 359 U.S. 65, 68 (1959). The Commission should be all the more reluctant when its Proposed Rule's parameters are defined by product features that are requirements of state law, such as minimum guarantees: The Commission cannot predicate a rule on a state law regulatory regime for *annuities*, and claim convincingly that it is regulating *securities.*

Indeed, the Commission is proceeding in an area where any claim to deference is at its low ebb. The McCarran-Ferguson Act, 15 U.S.C. § 1012(b), establishes a rule of construction under which federal law shall not be interpreted to "supersede any law enacted by any State for the purpose of regulating the business of insurance." McCarran-Ferguson "was intended to further Congress' primary objective of granting the States broad regulatory authority over the business of insurance." *U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491, 505 (1993). Even apart from the constraints imposed on the Commission by McCarran-Ferguson, the courts recognize that deference to an agency's legal interpretations is misplaced when the agency's action would expand its own jurisdiction. *See Adams Fruit Co. v. Barrett*, 494 U.S. 638, 650 (1990) ("'[A]n agency may not bootstrap itself into an area in which it has no jurisdiction.'" (quoting *Fed. Mar. Comm'n v. Seatrain Lines, Inc.*, 411 U.S. 726, 745 (1973)).

B. Courts' Interpretation of Section 3(a)(8) Confirm That Fixed Indexed Annuities Are Annuity Contracts Under The Act.

The Commission attempts, as it must, to harmonize its proposed rule with two Supreme Court decisions: *SEC v. Variable Annuity Life Insurance Co. of America*, 359 U.S. 65 (1959) ("*VALIC*"), and *SEC v. United Benefit Insurance Co.*, 387 U.S. 202 (1967). However, the products in those cases were fundamentally different from both traditional fixed rate annuities and fixed indexed annuities. The purchaser in those cases acquired a share in a fund managed by the issuing company and assumed virtually the entire investment risk—namely, the risk of significant loss of principal due to negative investment performance—while the company assumed virtually none. The value of fixed indexed annuities, by contrast, does not depend upon investment management by the issuing company, and the products provide a statutorily defined minimum guaranteed value as well as possibly higher values as a result of the interest crediting methodology.

The difference between the products in those cases and FIAs is thus large, whereas any difference between FIAs and traditional annuities is literally at the margins. Fixed indexed annuities are indeed annuities, they are regulated as such by the states, and the Proposed Rule is neither legally justified nor warranted.

1. *VALIC* And *United Benefit.*

The products at issue in *VALIC* were variable annuities. Purchasers paid premiums which were invested in a fund consisting largely of common stock. Annuitants received a proportionate interest in the investment fund, and benefits were paid according to the fund's after the fact, actual investment performance. There were no guaranteed payments, and the entire principal investment was thus subject to market performance. In the Court's words, the contracts "guarantee[d] nothing to the annuitant except an interest in a portfolio of common stocks or other equities—an interest which has a ceiling but no floor." *VALIC*, 359 U.S. at 72 (footnote omitted).

On these facts, the Court held that the products were securities falling outside the exemption of Section 3(a)(8). "[T]he variable annuity place[d] *all* the investment risks on the annuitant," the Court emphasized, and "*none* on the company." *Id.* at 71 (emphasis added). There thus was not "true underwriting of risks, the one earmark of insurance . . . ." *Id.* at 73. "[T]he concept of 'insurance' involves some investment risk-taking on the part of the company," the Court explained, and "absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant . . . ." *Id.* at 71. Because the variable annuity had "no element of a fixed return," the returns it provided depended entirely "on the wisdom of the investment policy"; it therefore was properly regulated as a security. *Id.* at 70.[10]

In *United Benefit*, purchasers' premiums were placed in a "Flexible Fund," which was maintained as a separate account. The company—whose marketing materials emphasized the investment acumen of the fund managers and the opportunity to "'share in the growth of the country's economy'"—invested the Fund "with the object of producing capital gains as well as an interest return, and the major part of the fund [was] invested in common stocks." 387 U.S. at 205 & n.3. At any time before maturity the purchaser was entitled—in the Supreme Court's words—"to his *proportionate share* of the total fund," and could withdraw all or part of his share. *Id.* at 205 (emphasis added). Alternatively, the purchaser could demand cash payment of a "net premium guarantee" that rose from 50 percent of his premium payments in the first year to 100 percent after 10 years. *Id.* at 205-06. This guarantee was largely illusory, since the company had set it "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.*" *Id.* at 209 n.12 (emphasis added). The guarantee was thus "low enough that the [company's] risk of not being able to meet it through investment [was] insignificant." *Id.* at 209. *See also Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127, 1132 (7th Cir. 1986), *rev'd on rehearing*, 814 F.2d 1140 (7th Cir. 1987) ("[I]n both [*VALIC* and *United Benefit*,] the insurance company guaranteed a minimum return so low as to place the investment risk on the investor rather than on the insurance company.").

At maturity, the purchaser's interest in the fund terminated, and he could receive the cash value of the policy—as measured by his interest in the fund or the net premium guarantee, "whichever [was] larger"—or he could have his interest converted into a life annuity under

---

[10] As noted, Justice Brennan based his concurring opinion on the view that "where [the investor shares in the investment experience of the insurance company itself], the federally protected interests in disclosure to the investor of the nature of the corporation to whom he is asked to entrust his money and the purposes for which it will be used become obvious and real." *Id.* at 78.

conditions specified in the contract. *United Benefit*, 387 U.S. at 205-06. As noted, the guarantee was so minimal that—based on market performance over the *past 50 years*—the company was expected to always have the returns to fund it from the purchaser's own payments.

In applying Section 3(a)(8), the Court first determined to analyze the accumulation period in which the purchaser was invested in the "Flexible Fund" as a free-standing product, since there was no necessary link to the annuity that the purchaser was able, but not required, to obtain at maturity. The Court then found "little difficulty" concluding that the Fund fell outside of Section 3(a)(8)'s provision for annuities and in fact was an investment contract under Section 2 of the Act. Far from being structured in a manner resembling traditional annuities, "'Flexible Fund' arrangements require special modifications of state law," the Court emphasized—specifically, their essentially illusory "guarantee" required an exemption from state nonforfeiture laws (which apply with full force to FIAs). *Id.* at 211. The products, the Court further emphasized, resulted in the purchaser literally holding a "proportionate share" in a Fund that had been marketed based on "the experience of United's management in professional investing" rather than on "the usual insurance basis of stability and security." *Id.* The fact that the company purported to back-stop the purchaser with a cash-value guarantee did not convert into an annuity an interest that, at heart, was simply a share in a fund invested in common stock. The purchaser was a shareholder, and the fact that his investment "to some degree is insured" by a minimal guarantee did not render his investment "a contract of insurance." *Id.*

2. Fixed Indexed Annuities Meet The *VALIC* And *United Benefit* Test.

Under the criteria applied in *VALIC* and *United Benefit*, fixed indexed annuities as characteristically structured are plainly annuities exempt from SEC regulation by Section 3(a)(8). The purchaser of a fixed indexed annuity is not subjecting his entire principal—*or any part of it*—to the vagaries of the market or the performance of an individual security. It is thus an entirely different arrangement than in *VALIC*, where the purchaser essentially had "nothing except an interest in the portfolio of common stocks or other equities." *VALIC*, 359 U.S. at 72. In *United Benefit*, where the purchaser again held a "proportionate share" in a fund of common stocks in a manner that was "somewhat similar to . . . the variable annuities" in *VALIC*, the Court made clear that providing (effectively illusory) insurance of the participant's securities investment did not thereupon convert an investment in securities into an insurance (or annuity) contract. The purchaser's interest was explicitly investment in a stock fund, and the Court treated it as such. *See also Assocs. in Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 941 F.2d 561, 567 (7th Cir. 1991) (Easterbrook, J.) ("*AIAP*") (distinguishing circumstances where "the seller [is] supplying only investment advice"). As observed in note 9 above, the Proposing Release places heavy reliance on the two-Justice concurring opinion in *VALIC* authored by Justice Brennan, yet the whole thrust of that opinion is that the securities laws are triggered when "investors . . . participate on an 'equity' basis in the investment experience" of the issuing company. *VALIC*, 359 U.S. at 79.

Fixed indexed annuities, by contrast, possess the essential elements of a traditional declared rate annuity except that purchasers' interest credit is tied to the performance of a stock index rather than being an express declared rate. Accordingly, state insurance laws themselves—which distinguish between variable and fixed products and exempt variable products from protections provided to fixed products, as *United Benefit* recognizes—classify

FIAs as fixed products and regulate them as such. The fact that an FIA's value may relate in part to equities' performance cannot be a sufficient reason to treat them as securities because if *any* link to a stock or group of stocks took a product outside of Section 3(a)(8), then *VALIC* and *United Benefit* would simply have said so. Rather than consult the multiple factors that it did, the Court would merely have observed that the products' value increased or decreased with the performance of equities; that this constituted "investment risk"; and that the products therefore were securities. The Court applied no such analysis—and the Commission may not apply it now.

In other respects as well, the contrast between FIAs and *VALIC* and *United Benefit* is plain. State nonforfeiture laws guarantee that a contract owner will receive no less than 87.5 percent of premiums even if the contract is surrendered in the first year, and assure that this amount will increase at a minimum annual rate of 1 to 3 percent for the life of the contract. This guarantee is real, genuine, and different in kind from the United Benefit guarantee that had required an exemption from state nonforfeiture laws in order to be set so low "that it would not have become operable." *United Benefit*, 387 U.S. at 209 n.12. In *United Benefit* the Court also placed significant weight on the fact that the Flexible Fund guarantees were "substantially" lower than guarantees for traditional annuities (*id.* at 208), whereas the guarantees for FIAs are quite comparable to those for traditional fixed annuities. *See* Exhibit A (showing that the guarantees in index products are comparable to those in traditional fixed-rate annuities).

For these and other reasons, purchasers of FIAs bear no "investment risk" as that term is properly understood, while the risk borne by the insurer is considerable. From the day of issue, purchasers of FIAs are assured that in the absence of early withdrawal they will receive their principal plus interest. Even in the event of early withdrawal, they are assured the lion's share of their principal due to state nonforfeiture laws. The insurer, on the other hand, must realize returns sufficient to fund payment of the guaranteed minimum value, as well as any index-related interest credits. The withdrawal charge itself is not an "investment risk," it is a charge of a type that is prevalent under an infinite variety of contracts whose economic value depends in part on their duration and which provide, accordingly, for compensation in the event of early termination. *See AIAP*, 941 F.2d at 567 (stating withdrawal charges do "nothing to throw *investment* risk on the investor") (emphasis in original). The charge typically decreases to zero over time and is limited so as to not encroach the minimum guaranteed value. It is taken regardless of the performance of the index, and has not been set or adjusted with reference to the long-term performance of any security or group of securities. *Compare United Benefit*, 387 U.S. at 209 n.12 (stating the company had set its guarantee "by analyzing the performance of common stocks"). Most policies annually exempt up to 10 percent of the value of the policy from withdrawal charges.

Finally, as noted at page 5 above, it is the practice of companies that issue FIAs and the states that regulate them to take numerous precautions to ensure that the products are marketed primarily for the safety and assurances that they offer, rather than as an invitation to share in the "investment experience" of the issuing company. *VALIC*, 359 U.S. at 78-79 (Brennan, J.).

For these reasons, the courts have had no difficulty determining that fixed indexed annuities and similar products are covered by Section 3(a)(8). Applying the principles articulated in *VALIC* and *United Benefit*, the court in *Malone v. Addison Insurance Marketing,* *Inc.*, found that the insurer of an FIA had assumed as much or more investment risk than the purchaser because it was obligated to return the premium plus the greater of 3 percent or the S&P Index, regardless of how the market performed. 225 F. Supp. 2d 743, 750 (W.D. Ky. 2002). The court noted that there was no direct correlation between the benefit payments and the performance of the investments made with the contract owner's premium. *Id.* ("Plaintiff's benefit payments from American Equity were not directly dependent on the performance of investments made with her money. That is to say, as a structural matter, Plaintiff's contract did not operate like a variable annuity: her payments were not a function of a personalized portfolio and her principal was not held in an independent account."). The only investment uncertainty assumed by the investor, the court found, was whether she would receive interest beyond 3 percent per year on her premium payment:

> Plaintiff's risk was not that she would lose the value of her initial investment, but rather the risk that had she chosen a different contract her money might have been worth more than 134 percent at the end of the ten-year contract period. That type of risk—that she could have gotten a better deal but for the pressure she encountered to enter into this particular contract—is not the type of risk central to determining whether a security exists.

Id. at 751.[11]

Other court decisions are consistent with *Malone* and conflict with the Proposed Rule's approach, under which all fixed indexed annuities would be deemed securities through a test that effectively ignores the risk borne by the insurer. In *AIAP*, for example, the Seventh Circuit held that a "Flexible Annuity" with characteristics similar to fixed indexed annuities fell within the Section 3(a)(8) exemption. In assessing the risks borne by insurer and insured, Judge Easterbrook noted that "[n]o annuity transfers all of the risk to the seller." Rather,

> [a]ny fixed annuity places on the buyer the risk that the seller's portfolio will perform too poorly to finance the promised payments. Section 3(a)(8) therefore necessarily exempts annuities that leave purchasers with some investment risk. If on the other hand a seller just pins the label "annuity" on a mutual fund, in which the buyer bears all of the risk, § 3(a)(8) is inapplicable.

941 F.2d at 566. The court also emphasized that with the product there, as with FIAs, the interest component did not depend upon the investment management or advice of the issuer such that it "made the 'annuity' look like a mutual fund, with the seller supplying only investment advice." *Id.* at 567. (It bears noting also that linking a company's obligation to pay to the performance of its own account directly moves risk from company to purchaser. By contrast, when a company must make payments based on factors other than its own portfolio's

---

[11] The Proposing Release acknowledges only *Malone*'s alternative holding that the fixed indexed annuity qualified under SEC Rule 151, while ignoring the court's holding that the fixed indexed annuity fell within Section 3(a)(8). *See* Proposing Release, at 37,757 n.41; *Malone*, 225 F. Supp. 2d at 751.

performance, no such direct transfer of risk occurs; the company bears the risk of having to pay regardless of its portfolio's performance.) *See also Olpin v. Ideal Nat'l Ins. Co.*, 419 F.2d 1250, 1261-63 (10th Cir. 1969) (considering risks to insurer and purchaser in connection with endorsement to life insurance); *Berent v. Kemper Corp.*, 780 F. Supp. 431, 442-43 (E.D. Mich. 1991) (single premium life insurance policy), *aff'd*, 973 F.2d 1291 (6th Cir. 1992); *Dryden v. Sun Life Assurance Co. of Canada*, 737 F. Supp. 1058, 1062-63 (S.D. Ind. 1989) (whole life insurance policies with dividend feature).

In *Otto v. Variable Annuity Life Insurance Co.*, 814 F.2d 1127 (7th Cir. 1986), *rev'd on rehearing* 814 F.2d 1140 (7th Cir. 1987), the Seventh Circuit initially applied *VALIC* and *United Benefit* to hold that a product with both a fixed interest rate and a non-fixed excess interest rate was not an annuity, but subsequently reversed itself based on a factor not present with fixed indexed annuities. In its initial decision in *Otto*, the Seventh Circuit understood that discretionary changes in the excess interest rate affected only new deposits, and that "past deposits would continue to earn the interest rate in effect at the time the deposit was made," that is, that "VALIC in effect guarantees the excess interest on every deposit for the life of the annuity contract." *Id.* at 1140. After briefing on a petition for rehearing the court reversed itself and held that the product was a security, because—briefing had disclosed—VALIC had the "unfettered discretion" to change the current (excess) interest rate on past deposits, as well as "the absolute right to stop all excess interest payments on all deposits, past or present." *Id.* at 1141. The "claimed right to change established excess interest rates and to eliminate excess interest payments entirely *at any time* surely tends to shift the investment risk from VALIC" to the purchaser, the court explained. *Id.* (emphasis in original). With fixed indexed annuities, by contrast, excess interest is typically locked-in once earned, becoming a guarantee for which the company then bears the risk. Further, the interest crediting formula is stated in advance, is subject to statutorily prescribed minimums, and, once set, may not be changed by the insurer during the stated period.

The Commission, for its part, took the position that even *with* the company's complete discretion to set excess interest rates, the product in *Otto* remained an annuity. The Commission filed a Supreme Court *amicus* brief urging certiorari to review and reverse a "case [that] has caused great interest and concern in the insurance industry." Brief for the United States as *Amicus Curiae* at 5, *Variable Life Annuity Ins. Co. v. Otto*, 486 U.S. 1026 (May 23, 1988) (denying certiorari) [hereinafter *Otto Amicus Brief*]. In marked contrast to its Proposing Release—where the risk borne by the company is effectively ignored—the Commission stated in *Otto* that "it is clear that the assumption of substantial 'investment risk' by the insurance company is one *crucial* factor." *Id.* at 6 (emphasis added). The government explained:

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

Id. at 7 (emphasis added and footnote omitted). By placing no weight on the investment risk assumed by the insurer in fixed indexed annuity contracts, the Proposed Rule now takes a position contrary to the Supreme Court's, the lower federal courts', and the Commission's own repeated pronouncements.

III. In Designating Fixed Indexed Annuities As Securities, The Proposal Misconstrues "Investment Risk," Misconstrues The Supreme Court Cases On Which It Purports To Rely, And Adopts A Test That Omits Factors That The Proposing Release Concedes Are Important In Distinguishing Annuities From Securities; The Proposal Is Arbitrary And Capricious And Should Be Withdrawn.

The Executive Summary to the Proposing Release promises a rule that is based "upon a familiar concept: The allocation of risk." "Insurance provides protection against risk," the Commission explains, "and the courts have held that the allocation of investment risk is a significant factor in distinguishing a security from a contract of insurance." Proposing Release at 37,752.

The rule and analysis that the Commission provides, however, fall short of those benchmarks. The courts have, as the Commission says, made the *allocation* of investment risk "a significant factor" in applying 3(a)(8). But the Proposing Release overlooks both sides of that allocation by ignoring the risk borne by the company; it distorts the two-sided nature of this allocation by adopting a novel definition of investor risk that is far from "familiar"; and it fails to give any weight to other factors emphasized by the Supreme Court and acknowledged by the Commission to be significant.

The Proposed Rule reaches an erroneous conclusion via an analysis that is arbitrary, capricious, and contrary to law. It should be withdrawn.

A. The Likelihood Of Additional Financial Returns Is Not "Investment Risk."

The Proposing Release posits that the likelihood of additional financial returns due to the performance of securities is "investment risk," and makes this effectively the sole determinant of whether a widespread and popular product that is regulated by every state in the country as an annuity is nonetheless a security for purposes of Section 3(a)(8). In doing so, the Release contorts the concept of "investment risk."

As used in *VALIC*, *United Benefit*, and common parlance, a purchaser's primary investment risk is the ***risk*** to his ***investment***—the possibility that his principal will be lost. It is for this reason that the Supreme Court placed more emphasis on the guarantee to the purchaser than on any other single factor, focusing intently on what assurance the purchaser had that he would get all or substantially all of his money back. An increased likelihood that after the withdrawal period an investor will get back a guaranteed amount *and more* is not risk at all—to the contrary, the more certain an investor is to receive an amount higher than what was guaranteed, the less risk he takes. *Compare Webster's New World Dictionary*, Second College Edition (1976) (defining risk as "the chance of injury, damage, or loss; dangerous chance; hazard," or, in the insurance sense, "a) the chance of loss b) the degree of probability of loss c) the amount of possible loss to the insuring company"). The indexed interest in FIAs is in fact a potential benefit. Although that benefit may be greater in one period than another, it does not affect the value of the underlying asset. In locating "investment risk" in the probability of earning additional money—the more, the riskier, evidently—the Commission has adopted a truly peculiar and insupportable predicate for its rule. *See* the further discussion in the September 10, 2008, Statement of Mark Meyer, Ph.D., attached as Addendum hereto.

The court in the *Malone* case recognized this basic economic truth: "Plaintiff's risk was not that she would lose the value of her initial investment, but rather the risk that had she chosen a different contract her money might have been worth more than 134 percent at the end of the ten-year contract period. *That type of risk—that she could have gotten a better deal but for the pressure she encountered to enter this particular contract—is not the type of risk central to determining whether a security exists.*" 225 F. Supp. 2d at 751 (emphasis added) (citing *VALIC*, 359 U.S. at 71). The possibility of extra benefits on a guaranteed contract is simply not a "risk" that may be made the central consideration in whether fixed indexed annuities are annuity contracts under Section 3(a)(8).

Indeed, the Commission's definition of risk in this manner has absurd consequences that further render it arbitrary, capricious, and contrary to law. Under the Commission's approach, an FIA with an interest crediting formula that was likely to yield no indexed interest would be deemed *not* to present risk to warrant regulation as a security. Suppose that a broker-dealer sits down with a client and tells her that two possible investments have been identified, one that is almost certain to return $100 and one that presents a high likelihood of plummeting to $40—and that he recommends she purchase the latter product because it presents less risk. Is that an analysis the Commission endorses? Ordinarily the Commission regards its regulatory interests to increase, not decrease when investors are induced to acquire products whose value is more likely than not to decline.

In addition to defying common sense, the approach of the Proposing Release turns *VALIC* and *United Benefit* on their head. The Court in both cases was concerned about circumstances where investors might lose their whole investment, or come away with nothing more than a minimal guarantee. The Commission now proposes to regulate precisely when the investor *will* receive a substantial guarantee and is likely to receive interest on top of this as well. That approach is insupportable. And to the extent the Commission's answer is that any equity-related component presents "investment risk"—either "upside" or "downside"—which is sufficient to render it a security, *VALIC* and *United Benefit* are a full reply to that as well: If *any link* to equities rendered a contract a security, then *VALIC* and *United Benefit* would simply have said so, rather than identifying the numerous considerations that the Proposing Release itself first acknowledges, then ignores.

The Commission's treatment of investment risk in the Release conflicts with its *amicus* brief in *Otto* as well. There, the Commission emphasized that purchasers "did not bear the common investment risk that changes in the market will erode *[their] capital contributions*." Additionally, the company "guaranteed an interest rate of 3-1/2% or 4% on principal and accrued interest so that Otto knew that her contributions would produce some income." *Otto Amicus Brief* at 7 (emphasis added). On these facts, the Commission deemed any risk borne by the purchaser to be insufficient to convert the contract to a security, even though—the brief acknowledged—the purchaser "did have some investment risk" because the product carried a declared rate of 14.5 percent; this was "over ten points higher than the guaranteed minimum rate"; and this excess rate (as well as excess interest earned in prior years) "*could be reduced or* *eliminated at [the company's] discretion.*" *Id.* at 8 (emphasis added). The Commission bears the burden of squaring the concept of "investment risk" set forth in this Proposed Rule with its prior statements in the Supreme Court.

The mistaken concept of investment risk in the Proposing Release causes the Commission to make a number of other misstatements. For example, the Proposing Release states that "[i]ndexed annuities are similar in many ways to mutual funds, variable annuities, and other securities," and that the purchaser of an indexed annuity "assumes many of the same risks that investors assume when investing in mutual funds, variable annuities, and other securities." Proposing Release at 37,757-59. That is profoundly inaccurate. The principal investment risk borne by purchasers of mutual funds and variable annuities is the loss or decline in value of their capital due to a decline in the underlying securities. That is the risk the Supreme Court focused on in *VALIC* and *United Benefit*, and it is not a risk borne by purchasers of fixed indexed annuities because of the guarantee to principal and minimum interest supplied by state nonforfeiture laws. The risk to one's principal investment posed by mutual funds and variable annuities simply is not comparable.[12]

B. *The Proposed Rule Fails To Consider Key Factors Identified By The Supreme Court In Applying Section 3(a)(8).*

In making a mistaken concept of "investment risk" effectively the sole determinant of when an FIA is actually a security, the Proposed Rule commits another fundamental error: It neglects other factors that the Supreme Court repeatedly has said are central considerations in applying Section 3(a)(8). Under the Supreme Court's cases, the Commission concedes,

---

[12] The mischaracterization of investment risk in the Proposing Release also leads it to inaccurately portray the role of withdrawal charges in fixed indexed annuities and annuities generally. Instead of treating them as a normal contract term, paragraph (b)(1) of the Proposed Rule provides in effect that withdrawal charges are not to be taken into account when determining amounts payable but are taken into account when determining amounts guaranteed. This effectively guarantees that FIAs with withdrawal charges will "fail" the test and become securities regardless of any other feature, since as long as there is a withdrawal charge the amount payable will exceed the amount guaranteed by at least the amount of the withdrawal charge. The Release attempts to justify excluding withdrawal charges from amounts payable by stating that the Commission is "proposing this calculation methodology in order to eliminate the differential impact that such charges would have on the determination depending on the assumptions made about contract holding periods." Proposing Release at 37,761. However, that "differential impact" based on assumed holding periods *is equally applicable to the determination of amounts guaranteed.* Neither the Release's rationale nor anything else justifies treating withdrawal charges differently in determining the amounts payable from the amounts guaranteed. The Commission's proposed treatment of withdrawal charges now also conflicts with its adoption of Rule 151, where it stated that a withdrawal charge "normally does not shift additional investment risk to the contract owner." Definition of Annuity Contract or Optional Annuity Contract, Release No. 33-6645, 51 Fed. Reg. 20,254, 20,257 n.20.

"[F]actors that are important to a determination of an annuity's status under Section 3(a)(8) include (1) the allocation of investment risk between insurer and purchaser, and (2) the manner in which the annuity is marketed." Proposing Release at 37,755. Yet, the Proposed Rule provides for no consideration of the investment risk borne by the insurer, nor for how the FIA is marketed. These omissions conflict with *VALIC*, *United Benefit*, and the entire body of Section 3(a)(8) caselaw. They render the Proposed Rule arbitrary and capricious and contrary to law for that reason, and because the Commission has proposed a rule that fails to give effect to the "facts and circumstances factors" that the rule's Proposing Release says are determinative. Proposing Release at 37,757.[13]

1. The Proposed Rule Improperly Omits Consideration Of Insurers' Investment Risk.

In *VALIC* and *United Benefit*, the Supreme Court considered the risk borne by both insurer and insured and in reaching its decision in both cases emphasized that the insurer took virtually no investment risk. In the words of the Commission's Supreme Court *amicus* brief in *Otto*, "[I]t is clear that the assumption of substantial 'investment risk' by the insurance company is one *crucial* factor." *Otto Amicus Brief* at 6 (emphasis added). Yet, the Proposing Release essentially focuses exclusively on the purported risk borne by the purchaser, without meaningfully acknowledging or discussing the risks of the insurer.

That is error, and whatever rule the Commission adopts must give significant weight to the risk borne by the company. That requires an analysis of the guarantees provided by the company because each guarantee places an investment risk on the company (and, conversely, takes that risk off of the purchaser). In a typical fixed indexed annuity, the insurer bears significant investment risk by providing (1) guarantees of principal, (2) guarantees reflected in the minimum nonforfeiture value or otherwise, (3) guarantees of previously credited interest, (4) the guarantee to credit indexed interest in accordance with the performance of the relevant index and the terms of the contract, and (5) for the establishment of the precise terms of the index interest crediting method prospectively, at the beginning of each term. Importantly, while a stock index's failure to indicate indexed interest credits in a given year does not itself cause loss to the insurer, the insurer assumes risk in the years the index *does* require credits because under the typical contract it locks those gains in for the purchaser and guarantees them regardless of the performance of the insurer's investments in the years ahead. In this respect a down year in the markets can indeed increase exposure for the insurer because the company may experience a *decrease* in the funds that *it has* available to cover its guarantees even as the purchaser is assured

[13] The Commission's narrow approach is also inconsistent with the approach courts have taken in applying insurance exceptions found in other federal statutes, such as the McCarran-Ferguson Act and ERISA. *See, e.g., Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982) (explaining multiple factors in determining the "business of insurance" exception in McCarran-Ferguson); *Ky. Ass'n of Health Plans v. Miller*, 538 U.S. 329, 330, 342 (2003) (applying ERISA insurance exception when it "substantially affect[s] the risk pooling arrangement between the insurer and the insured").

previously credited interest and the increase set forth in the guaranteed minimum non-forfeiture value provided under state law.

The insurer takes on risk in other respects as well: Risk inheres in the limits many contracts place on the company's ability to change the terms of the indexed interest crediting method (*i.e.*, limits on changes in caps, participation rates, spreads, etc.) during the life of the contract. Further risk results from limitations on, and the uncertainty of, the company's ability to hedge against its risks. And, the courts and Commission have recognized that the company's assumption of mortality risk must be weighed under Section 3(a)(8). *See VALIC*, 359 U.S. at 71; *Grainger v. State Sec. Life Ins. Co.*, 547 F.2d 303, 305 (5th Cir. 1977); Definition of Annuity Contract or Optional Annuity Contract, Release No. 33-6645, 51 Fed. Reg. 20,254, 20,256; *Otto Amicus Brief* at 9.

Finally, the Proposed Rule fails because it does not *weigh* the investment risk borne by the company against that borne by the purchaser and because its focus on the purchaser's indexed interest "risk" lacks any proportionality—it addresses solely whether any indexed interest is likely to be paid and not the potential *amount* of indexed interest relative to the guaranteed amounts. There is no assessment of where the greater risk lies; rather, the proposal essentially converts *VALIC*'s concern that the purchaser not bear *all* the risk into a rule that the purchaser bear *no* risk. Under the caselaw that is clear error, and for a rule that purports to be founded on "a familiar concept: the *allocation* of risk," it is arbitrary and capricious. Proposing Release at 37,752 (emphasis added).

2. The Proposed Rule Does Not Consider Product Marketing.

The Supreme Court has made clear that marketing must be taken into account in applying Section 3(a)(8), and the Proposing Release acknowledges as much, stating that marketing "is another significant factor" in applying the exemption. Proposing Release at 37,756 (citing *United Benefit*, 387 U.S. at 211).[14]

---

[14] It was important in *United Benefit* not merely that the Flexible Fund was being marketed as an *investment* (all annuities are investments to a degree), but that the company was marketing *its own investment management*. United Benefit trumpeted "the experience of United's management in professional investing," the Court observed in the passage cited in the Proposing Release, and thereby "pitched to the same consumer interest in growth *through professionally managed investment*" as mutual funds do. 387 U.S. at 211 & n.15 (emphasis added). Fixed indexed annuities are not marketed on the basis of the companies' investment acumen at all, since—unlike *VALIC* and *United Benefit*—the performance of purchasers' equity-related component has no relationship to the issuer's investment experience. *Compare also* Justice Brennan's concurrence, 359 U.S. at 78, emphasizing that with annuities the purchaser is not "a direct sharer in the company's investment experience," whereas when "the coin of the company's obligation is . . . the present condition of its investment portfolio," "the federally protected interests" underlying the securities laws are triggered.

Despite this, the Proposed Rule takes no account of marketing. Instead, the text of the Proposed Rule effectively designates all fixed indexed annuities as securities even though—as discussed above—companies' descriptions of the products are ordinarily careful to emphasize the guarantee of principal, minimum interest, and other features that further financial stability and security, and promotional materials explain the interest crediting feature and that it is not a means of participating in the stock market. Three representative marketing brochures are attached herewith as Exhibit C. In this respect, too, the Commission has arbitrarily and capriciously purported to rely on Supreme Court cases interpreting 3(a)(8), yet adopted a test that omits factors that the Commission itself recognizes to be "significant."

* * *

In *VALIC* and *United Benefit* the Supreme Court evaluated products whose value depended largely or entirely on the performance of equities and considered multiple factors before determining those products to be securities. The Proposing Release, while paying lip service to the multiple factors considered by the Court, effectively adopts a bright line rule under which an annuity whose value depends at all on the performance of equities is a security instead. That manifestly is not the law.

IV. The Costs of Rule 151A Would Greatly Exceed Its Benefits, And The Rule Would Hinder Efficiency, Competition, And Capital Formation.

The Commission is required by law to consider the effects of the Proposed Rule on efficiency, competition, and capital formation. It is prohibited from adopting "any . . . rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [this chapter]," and a failure to adequately appraise a rule's effects on efficiency, competition, and capital formation will itself result in invalidation of the rule. Proposing Release at 37,771 (citing 15 U.S.C. §§ 77b(b); 78c(f)); 15 U.S.C. § 78w(a)(2); *see also Chamber of Commerce v. SEC*, 443 F.3d 890 (D.C. Cir. 2006).

The analysis in the Proposing Release of the Rule's costs and benefits—and accordingly, its effect on efficiency, competition, and capital formation—is plainly deficient. The release betrays a profound misapprehension of the scope and extent of existing state regulation of FIAs, and as a consequence claims benefits from SEC regulation that are illusory because the claimed benefits of regulation already are being realized. The result is that the Proposed Rule will increase regulatory costs with no compensating benefit; indeed SEC regulation in this area would frustrate regulatory initiatives that the states and FINRA have recently launched at the SEC's own encouragement. *Compare VALIC*, 359 U.S. at 68 ("We start with a reluctance to disturb the state regulatory systems that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements."). *And see* Comment of National Governors' Association (Sept. 4, 2008) (stating the Proposed Rule would "subject[] these products to dual regulation").

In short, FIAs are annuities that are comprehensively regulated by state law, and by exceeding the parameters delineated by the Court and Congress—as shown in the preceding sections—the Proposed Rule will impose excessive, unjustifiable costs that impair efficiency, competition, and capital formation.[15]

A. The Proposed Rule Is Not Efficient.

The Commission is claiming that through this regulation, it will achieve efficiencies. Because annuities already are extensively regulated, however, the Commission cannot claim further efficiencies without a comprehensive consideration of the existing state law regulatory regime, the efficiencies that regime already realizes, and—correspondingly—the respects in which that state regime falls short and further gains may be achieved by the Commission. And yet, to the extent it refers to state regulation at all, the Proposing Release betrays a serious misapprehension of state law requirements. The regulation of annuities may vary from state-to-state, although states increasingly are adopting model rules proposed by industry and regulatory associations. Further, many companies incorporate the practices endorsed by the model rules into their nationwide policies, with the effect that model disclosure and suitability practices are followed by leading providers in all states.

The Proposing Release states that state insurance regulation "is focused on insurance company solvency and the adequacy of insurers' reserves." Proposing Release at 37,762. That is incorrect; state regulation of fixed indexed annuities and other annuities and insurance products is far broader and includes the following:

- Suitability requirements. As discussed more fully below, suitability regulations require an agent to consider the financial profile of a potential purchaser and other factors to determine whether purchase of a fixed indexed annuity would be appropriate.

- "Free Look" periods. Allow a purchaser to rescind a purchase of a fixed indexed annuity, typically up to 15 days after purchase.

- Annuity disclosure requirements. As discussed more fully below, states require significant disclosure about the contents, terms, and conditions of fixed indexed annuities.

[15] As reflected in the statement by the Court in *VALIC*, existing state regulation of annuities presents questions of federalism that must be weighed by the Commission. The President has directed by Executive Order that when federalism concerns are present, agencies should "encourage States to develop their own policies to achieve program objectives and to work with appropriate officials in other States" and, "where possible, [agencies should] defer to the States to establish standards." Executive Order 13132, *Federalism*, 64 Fed. Reg. 43,255, 43,256 (Aug. 4, 1999). This Order does not apply to the Commission by its terms, but reflects solemn considerations that the Commission must weigh.

- Advertising laws. States limit the manner in which fixed indexed annuities are marketed. Several states require that companies submit to the responsible agency materials regarding both the product and the product advertising, to monitor whether the product will be marketed in a way that is understandable to consumers. *See, e.g.*, GA. COMP. R. & REGS. 120-2-71-.15 (6) (2008).

- Unfair trade practices and penalties. States regulate deceptive and unfair trade practices, including misrepresentations or misleading statements regarding fixed indexed annuities, and use their enforcement and investigative authority to pursue complaints regarding any type of annuity product. *See, e.g.*, NAIC Model Unfair Trade Practices Act §§ 3-4. Insurance agents can receive penalties or fines for violating certain sales rules as well.

- Market conduct reviews of insurers. Insurers' products and business practices receive a top-down review from state authorities on a periodic basis (usually every three years), giving the state an opportunity to assure itself that products are being designed and marketed within the parameters of state law.

- Agent licensing and training. States require insurance agents to be knowledgeable about the products they sell and the laws that govern those products and to verify the suitability of annuity products for potential purchasers. For example, Iowa requires the completion of a four-hour training course specific to indexed products and that each insurer have a system in place to verify compliance with the training requirement. IOWA ADMIN. CODE r. 191-15.82, 15.84.

Beginning as it does with a misapprehension of the nature and extent of state insurance regulation, the Proposing Release proceeds to claim efficiencies from "extending the benefits of the ***disclosure*** and ***sales practice protections*** of the federal securities laws" to fixed indexed annuities; those protections, the Proposing Release claims, "would enable investors to make more informed investment decisions." Proposing Release at 37,771 (emphases added).

1. State Law Extensively Regulates Disclosures.

With respect to disclosures specifically, the Proposing Release claims that the rule will yield benefits by requiring disclosure of "information about costs (such as surrender charges); the method of computing indexed return (*e.g.*, applicable index, method for determining change in index, caps, participation rates, spreads); minimum guarantees, as well as guarantees, or lack thereof, with respect to the method for computing indexed return; and benefits (lump sum, as well as annuity and death benefits)." Proposing Release at 37,768. Remarkably, however, companies selling fixed indexed annuities *already* disclose this information to potential purchasers. A representative disclosure statement is attached herewith as Exhibit D. For example, the Annuity Disclosure Model Regulation of the National Association of Insurance Commissioners ("NAIC"), which has been adopted by 22 states, requires disclosure of the following on annuity contracts:

- An explanation of the initial ceiling rate, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;

- The guaranteed, non-guaranteed, and determinable elements of the contract, their limitations, if any, and an explanation of how they operate;

- Periodic income options both on a guaranteed and non-guaranteed basis;

- Any value reductions caused by withdrawals from or surrender of the contract;

- How value in the contract can be accessed;

- The death benefit, if available, and how it will be calculated;

- A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and

- The impact of any rider, such as a long-term care rider.[16]

In many states, the purchaser and insurance agent are both required to sign disclosure statements as a condition of policy issuance. And states that have not yet adopted the NAIC's Annuity Disclosure Model Regulation have alternative, significant disclosure requirements. For example, New York requires that a company selling a fixed-indexed annuity disclose "a statement in bold type to the effect that the [fixed indexed annuity] provides benefits linked to an external equity index and does not participate directly in the equity market." N.Y. INS. LAW § 3209(b)(2)(A). New York also requires disclosure about the equity index formula, participation rates, any caps on the index, minimum guaranteed values, and withdrawal charges. *Id.* California requires explicit disclosure about surrender charges and requires specific disclosures for agents doing business in the homes of seniors. CAL. INS. CODE §§ 789.10, 10127.13.[17]

---

[16] Annuity Disclosure Model Regulation Section 5(B).

[17] Although not all model laws and regulations promulgated by the NAIC have been adopted by all states, it is important to note that many model laws are accepted by insurance companies as establishing a floor of conduct for their business across the country. For example, most companies substantively comply with the disclosure requirements of the NAIC Annuity Disclosure Model Regulation even though not every state has adopted that model regulation. So even though some laws vary from state to state, companies that operate nationally tend to follow many of the model laws and regulations for purposes of uniformity and efficiency. And of course, states that have not adopted model regulations often adopt their own requirements to provide comparable protections.

Many states also require insurers to deliver a buyer's guide, written by the NAIC, at the point of sale for fixed annuities, including fixed indexed annuities. *See* Exhibit B. The 9-page guide provides a simple, easy-to-understand description of different types of annuities and explains the components of fixed-indexed annuities, such as indexing method, charges and administrative fees, and withdrawal penalties. The guide also identifies questions a potential purchaser should ask about a fixed-indexed annuity before purchasing the product. Meanwhile, industry groups such as the American Council of Life Insurers ("ACLI") and the Association for Insured Retirement Solutions ("NAVA") have been actively working with the NAIC, FINRA, and the SEC itself to develop short-form, plain English disclosure templates that harmonize and simplify the disclosures provided to annuity purchasers. These templates are expected to establish a uniform format for fixed, indexed and variable annuities, so that consumers receive readable, comparable information across products and companies. These documents pass the "Flesch" test, a test that all annuity contracts must pass which analyzes the document for comprehension by a reader at the 10th grade level.

As FINRA and the SEC itself evidently have recognized in promoting the development of short-form, point-of-sale disclosure materials, materials of this nature most effectively communicate the necessary disclosures to purchasers of annuities. There is no basis to believe that the prospectus required by Form S-1 (the registration statement form on which most fixed indexed annuities would be registered), which has been designed to provide information on a fundamentally different type of financial product and its issuer, will provide more effective disclosures than materials honed from years of experience to communicate information on annuities specifically. These types of prospectuses are in fact too lengthy and complex to function as effective disclosure vehicles for annuity products. Many of its disclosure requirements—such as executive compensation and a description of the company's business—are irrelevant to purchasers of fixed indexed annuities. Nor can a document as lengthy and complex as a prospectus serve as an effective disclosure vehicle at the point-of-sale, which is the point at which disclosures about annuities have been judged to be most valuable. Indeed, a prospectus may very well obscure the information that a potential purchaser of fixed indexed annuities would most benefit from knowing.[18]

In short, the SEC has no basis to claim benefits from applying disclosure requirements that it designed for fundamentally different products to an area where there is a pre-existing

---

[18] The Commission's requirements are ill-suited to FIAs in many other ways as well. For example, in a typical securities offering, the company must register a particular dollar amount of securities and pay a registration fee based on that amount. Selling or issuing more than that dollar amount results in selling unregistered securities, with concomitant legal consequences. This dollar amount requirement is generally easily satisfied in a typical securities offering, but would create an obligation on the part of issuers of FIAs to constantly monitor the amount sold versus the amount stated in the registration statement. Also, because FIAs would be offered on a continuous basis, the registration statement would have to be refiled and updated annually in the form of a post-effective amendment subject to Commission review, further increasing the burden.

disclosure system developed—with the encouragement in part of FINRA and the SEC—to effectively impart information about annuities specifically.

2. Sales Practices Are Heavily Regulated By The States.

As to the supposed benefits from SEC "sales practice protections," the Proposing Release cites a single instance of the claimed protections: The application of broker-dealer requirements, it claims, would impose an "obligation to make only recommendations that are suitable." Proposing Release at 37,768. Once again, however, the state regulatory regime *already* imposes extensive suitability requirements. In 2003 the NAIC adopted the Senior Protection in Annuity Transactions Model Regulation, which in 2006 was expanded to purchasers of all ages and re-named the Suitability in Annuity Transactions Model Regulation. The Model Regulation—which already has been adopted in more than 33 states—provides for robust standards and procedures to ensure that the "insurance needs and financial objectives of [purchasers or annuities] at the time of the transaction are appropriately addressed." The Regulation's protections exceed those in FINRA suitability Rule 2310 by imposing a supervisory role on insurers and requiring that, among other things, insurers endeavor to obtain information on consumers' financial status, tax status, investment objectives, and other information appropriate for making informed recommendations to the consumer. *See* NAIC Suitability in Annuity Transactions Model Regulation § 6(B), (D). In May 2007, FINRA jointly released a statement with regulators from North Dakota, Iowa, and Minnesota in support of the NAIC Model Annuity Suitability Regulation; the statement is the first significant initiative of the Annuity Working Group, which was established by the Minnesota Department of Commerce and FINRA following the May 2006 Annuity Roundtable to evaluate the regulatory standards governing annuities.

Once again, moreover, states have adopted suitability requirements separate from the NAIC model rules. Florida, for example, recently enacted laws requiring agents to have an objectively reasonable basis "for believing that the recommendation [for a product] is suitable for the senior consumer based on the facts disclosed by the senior consumer as to his or her investments and other insurance products and as to his or her financial situation and needs." FLA. STAT. § 627.454(4)(a) (2008). In making the suitability determination, the agent must gather relevant information from the senior consumer. *Id.* § 627.4554(4)(b).[19]

Importantly, these state suitability requirements have—unlike FINRA requirements—been tailored to annuities and annuity-like products specifically, which present different suitability questions than securities. A consumer's suitability to purchase a security is primarily a matter of *risk tolerance—i.e.*, the consumer's inclination and ability to take investment risk. Suitability for an annuity, on the other hand, is seen as concerned primarily with *liquidity*, that is,

[19] A review of actual responses to these suitability forms refutes the unsubstantiated assertion in the Proposing Release that "[i]ndexed annuities are attractive to purchasers because they promise to offer market-related gains." *Id.* at 37,752. A sampling by some Coalition members of recent suitability forms reveals that the large majority of purchasers acquire fixed indexed annuities for stability of premium.

whether the initial payment and flow of income provided by the annuity are appropriate for the purchaser. In short, the suitability requirements that the Proposing Release identifies as a benefit of the rule are unnecessary in light of comprehensive state requirements, and are a poor fit in any event with the needs of purchasers of annuities. Sample suitability statements are attached as Exhibit E.[20]

In addition to the measures identified above, further enhancements to state requirements are underway. State regulators have charged the Suitability in Annuity Sales Working Group of the NAIC's Life and Annuity "A" Committee with developing uniform guidelines for agent training, supervision, and monitoring to further protect consumers from improper sales and marketing practices. The "A" Committee is also considering a model NAIC regulation to prohibit the misleading use of senior-specific certifications and designations by agents in the solicitation and sale of life insurance or annuity products. And, the ACLI is developing Suitability Monitoring Standards for use in implementing the supervisory procedures in the NAIC Suitability Model Regulation. These Monitoring Standards build upon SEC and FINRA rules and guidance on supervisory "best practices," including the recommendations in the *Joint SEC/NASD Report on Examination Findings Regarding Broker-Dealer Sales of Variable Insurance Products* (June 2004).

Yet another state initiative not accounted for in the Proposing Release is the Interstate Insurance Product Regulation Commission ("IIPRC"), an interstate compact that allow insurers in participating states to make one product registration filing—via an electronic filing system—to seek approval of their product in all participating states. *See* www.insurancecompact.org. The IIPRC adopts uniform product standards and assists the member states in enforcing those standards. The IIPRC was adopted in March 2004 and became operational in May 2006; 33 states have already joined the IIPRC, and five others have legislation pending to join. The IIPRC has adopted standards regarding registration of fixed indexed annuities including, among other things, the readability of contract forms presented to purchasers. *See* www.insurancecompact.org/rulemaking_records/080530_Ind_Imm_NonVar.pdf.

Finally, and as noted, state laws provide additional protections beyond the regulation of disclosure and sales practices that the Commission claims as benefits of the Proposed Rule. Annuity writers are subject to market conduct examinations by the insurance regulator in their state of domicile and in any other state where they do business. These wide-ranging exams focus increasingly on product suitability. Annuity writers are also subject to state unfair trade practice statutes which prohibit the misrepresentation of product terms and conditions, and are within the jurisdiction of the state attorneys general, several of whom have brought high profile

---

[20] There are a number of features of FIAs that can make them particularly appropriate for senior citizens. For example, FIAs help avert risk, protect against inflation, provide tax deferral advantages, protect assets from creditors and fraud, avoid probate delays, and, in some cases, compensate purchasers for nursing home care. *See* September 10, 2008, Statement of Mark Meyer, Ph.D., at 7-12 (attached as Addendum hereto).

enforcement cases alleging unsuitable sales and replacements of fixed and indexed annuities to seniors.[21]

For all of the reasons identified above, the measures that the Proposing Release claims as benefits are in fact protections that are currently provided—or are exceeded—under existing law. The Rule would only impose further costs and burdens on efficiency with no compensating benefit, adding on top of existing state laws an unnecessary, largely duplicative layer of federal requirements that were developed around securities generally and have not—like this extensive state regulation—been tailored to annuity products and purchasers particularly. The Proposing Release estimates that registration requirements alone would impose $82 million in additional costs. Proposing Release at 37,770. In fact the costs will be much higher due, for example, to the costs to insurance agents who do not currently have a securities license. The cost to an individual agent of registering *and operating* as a broker-dealer would be prohibitively expensive. According to Schedule A of the FINRA bylaws, registration and examination fees can be up to $4,000. In addition to these fees, the legal costs of registering and applying for membership with FINRA, the cost of completing the necessary forms, and the costs of ongoing compliance could require a "start-up" cost of $25,000 and between $50,000 to $100,000 annually to maintain the registration. Agents would also have to meet CLE requirements, pay licensing fees, and buy study materials or enroll in a course to pass licensing examinations.

In light of these costs, evidently, the Proposing Release concedes that individual and small distributors not currently registered as broker-dealers will likely forgo registration and enter into networking arrangements with registered broker-dealers. *Id.* at 37,772. This alternative will also be inordinately expensive, however, because under current industry practice

---

[21] The Release states that growth in the sale of fixed indexed annuities has been accompanied by an increase in complaints of abusive sales practices. No factual support is provided for that statement, and the Proposing Release simply errs in stating that "concerns about potentially abusive sales practices and inadequate disclosure have grown." Proposing Release at 37,755. In fact, NAIC data reflect that fewer "closed confirmed" complaints have been made regarding FIAs than either variable annuities or fixed-rate annuities. The Proposing Release also relies on a statement the former president of NASAA made regarding fixed investment annuities and senior investment fraud, *id.* at 37,755, but NASAA has refused requests by Coalition members that it provide information that supports these claims. (NASAA, unlike the NAIC, does not maintain a system for recording complaints about annuities products.) The reliance of the Proposing Release on the joint examination of free lunch seminars, *id.*, is also misplaced. The "free lunch report" examined broker-dealers' compliance with the securities laws in "free lunch" seminar sales. The report did not examine independent insurance agents, who are the principal sellers of fixed indexed annuities. Within the report, moreover, fixed indexed annuities are mentioned only three times, with the report's dominant focus being on mutual funds, real estate investment trusts, variable annuities, private placements of speculative securities—such as oil and gas interests—and reverse mortgages. The report simply did not demonstrate that fixed indexed annuities presented a particular problem or were even extensively offered at "free lunch" events.

the agent will *still* bear expenses that include examination fees, state registration fees, and possibly a pro rata share of the associated broker-dealer's increased compliance costs, such as costs associated with capturing and supervising electronic communications pursuant to Exchange Act rule 17a-4(b)(4) and FINRA Rule 2210. And of course, the agent will have to share a portion of his commissions with the registered broker dealer. Altogether, one industry commentary estimates that total costs of the rule will exceed $700 million. Jack Marrion, *The Proposed Rule Will Sock It To Index Annuity Distributors*, National Underwriter, *available at* http://www.lifeandhealthinsurancenews.com/cms/nulh/Weekly%20Issues/issues/2008/29/Focus/L29cover2.[22]

The Commission's failure to address the extensive state regulation in this area contrasts notably with the numerous recent occasions in which it has recognized the importance of avoiding duplicative regulatory and enforcement systems. In adopting Regulation R, for example, which exempts banks from broker-dealer registration for certain activities, the Commission actively "sought to minimize" duplicative regulatory burdens and to defer to banking regulators. *Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks*, 72 Fed. Reg. at 56,514, 56,549 (Oct. 3, 2007). Currently, the Commission is requesting comment on a program to reallocate responsibilities for surveillance and detection of insider trading among various securities exchanges, again to avoid "regulatory duplication [that] would add unnecessary expenses." *Program for Allocation of Regulatory Responsibilities*, 73 Fed. Reg. 48,248, 48,248 (Aug. 18, 2008). And, in another recent change announced with much fanfare, the Commission will exempt foreign private issuers from registration requirements of Section 12(g) of the Exchange Act if, among other things, non-U.S. disclosure documents are posted on the company's website. *See Exemption from Registration Under Section 12(g) of the Securities Exchange Act of 1934 for Foreign Private Issuers*, 73 Fed. Reg. 10,102, 10,105 (Feb. 25, 2008). In each of these cases, the Commission crafted its proposal in light of the existing regulatory regime for the particular product or practice, with the objective of avoiding or eliminating unnecessary regulatory duplication. The failure to do so here is further evidence that the Commission has proceeded in a precipitous, arbitrary, and capricious manner.

B. The Proposed Rule Would Impair Competition.

The assessment in the Proposing Release of effects on competition is, like its efficiency analysis, flawed and incomplete.

The Release speculates that enhanced disclosure requirements and the removal of regulatory uncertainty regarding the status of fixed indexed annuities under the securities laws will encourage more broker-dealers and insurers to enter the market. Proposing Release at 37,769. That is mistaken. As an initial matter, the "regulatory uncertainty" described by the

---

[22] Several comments to the Proposed Rule have cited this analysis. *See, e.g.*, Comment of Courtney A. Juhl (Aug. 15, 2008); Comment of Bruce E. Dickes (July 16, 2008); Comment of Dane Streeter (July 16, 2008); Comment of Michael A Harness, Jr. (July 10, 2008); Comment of Andrew Unkefer (July 7, 2008).

Commission is a makeweight; the market for fixed indexed annuities is robust—as the Proposing Release observes elsewhere—and any "uncertainty" regarding the legal classification of FIAs is as easily dispelled by the Commission *rejecting* the Proposed Rule as it is by adopting a rule that could draw legal challenge due to its plain tension with Supreme Court precedent.

With respect to the possibility that more broker-dealers and insurers might enter the market, all evidence points to the contrary, as the Proposing Release admits could be the case:

> If some insurers determine to cease issuing indexed annuities rather than undertake the analysis required by Proposed Rule 151A and register those annuities that are outside the insurance exemption under the Proposed Rule, there will be fewer issuers of indexed annuities, which may result in reduced competition. Any reduction in competition may affect investors through potentially less favorable terms of insurance products and other financial products, such as increases in direct or indirect fees.

Proposing Release at 37,770. Currently, more than 90 percent of fixed indexed annuities are distributed by independent insurance agents, rather than by broker-dealers. Advantage Group Associates, Inc., Advantage Index Sales & Market Report 4th Quarter 2007 Part 1, at 10 (2008). Many of those independent insurance agents lack the securities licenses that would be required if fixed indexed annuities were to become subject to the securities laws. If the Proposed Rule is adopted, a significant percentage of these agents must be expected to cease selling FIAs after concluding that the cost of being licensed and subject to additional regulation as broker-dealers is not worth the benefits of selling fixed indexed annuities. Indeed, one recent report shows that this already is the trend in the industry, with more people who sell insurance products dropping their securities licenses than acquiring them, citing, among other things, the costs of compliance and continuing education to maintain licenses for products that represent a small portion of the agent's portfolio.[23] The Proposed Rule will exacerbate this trend, thereby constraining consumers' choices and increasing prices by reducing competition and raising costs among those who do remain in the market.

C. *The Proposal Would Not Promote Capital Formation.*

Regarding capital formation, the Proposing Release claims only that benefits will result from "improving the flow of information between insurers that issue indexed annuities, the distributors of those annuities, and investors." Proposing Release at 37,771. No "improvements" can be claimed, however, without delineating where the states' current, highly-developed means for providing information fall short; the respects in which a system designed to govern the "flow of information" about securities will improve on the informational practices and requirements tailored specifically to products with the features of an annuity; and how those supposed benefits will exceed the costs that undeniably they will impose.

---

[23] *Practice Management Support: Giving Producers What They Need Industry Report* 9-10 (LIMRA 2008).

* * *

The Commission lacks the legal authority to regulate fixed indexed annuities and doing so would be a poor policy decision that gives short-shrift to extensive state regulatory efforts. The Proposed Rule would impose substantial, needless costs on those who sell and buy these valued products, and cannot be reconciled with the Commission's obligation to give due weight to the effects of its actions on efficiency, competition, and capital formation.

V. The Proposed Rule Would Impose Unjustified Costs On Small Business In Particular.

Under the Regulatory Flexibility Act, the Commission is required to prepare a "regulatory flexibility analysis" unless it can certify that the Proposed Rule will not "have a significant economic impact on a substantial number of small entities." 5 U.S.C. §§ 603(a), 605(b). The Commission has made no such certification—it has prepared an initial regulatory flexibility analysis instead—and thereby tacitly concedes that the Proposed Rule would in fact have a significant economic impact on small businesses and the men and women who own them and work for them. Proposing Release at 37,771-73.

In fact, the Proposed Rule understates the extent to which the costs identified in Section IV above would fall on small businesses in particular. The Release states "that there may be small entities among distributors of indexed annuities" and that the Rule would affect those "who are not currently parties to a networking arrangement or registered as broker-dealers." Those distributors, the Release theorizes, would opt to contract with registered broker-dealers in order to continue distributing FIAs. This would impose "legal costs in connection with entering into a networking arrangement with a registered broker-dealer, as well as ongoing costs associated with monitoring compliance with the terms of the networking arrangement." Proposing Release at 37,772.

The true costs would be higher as just shown: If the agents who currently sell FIAs forgo registration as broker-dealers, as they are likely to do, then by contracting with broker-dealers they would incur not only legal costs and monitoring costs, but also have to share commissions that they earn from FIAs. That would function as an additional incentive not to offer the product, increasing the likelihood that the effect of this Proposed Rule would be to seriously impair the existing distribution channels for fixed indexed annuities, curtailing the products' availability, and increasing their cost.

Conclusion

For all the reasons set forth above, the Coalition for Indexed Products respectfully requests that the Commission decline to adopt Proposed Rule 151A, and instead affirm that fixed indexed annuities are annuities, not securities.

Of counsel:

Eugene Scalia
Daniel J. Davis
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Ave., N.W.
Washington, D.C. 20036-5306
Telephone: (202) 955-8500
Facsimile: (202) 467-0539

ADDENDUM

Statement of Mark F. Meyer, Ph.D., Regarding SEC Proposed Rule 151A

I am a Vice-President and co-leader of the Insurance Economics Practice at CRA International. I received a Ph.D. in Economics from the University of Michigan in 1987, with concentrations in industrial organization, econometrics, and applied microeconomic theory. Since then, as detailed in the attached *curriculum vitae*, I have been employed at a major law firm and several economic consulting firms applying economic, financial and quantitative theory and practice to a range of business and public policy issues.

I have been requested by the Coalition for Indexed Products to review a new rule proposed by the Securities and Exchange Commission[1] that would likely classify a certain type of annuity, denoted "indexed annuity"[2] in the SEC's materials, as a financial security subject to regulation by the SEC. This Proposed Rule 151A has many implications for a wide range of parties and will undoubtedly elicit numerous comments covering a wide range of issues. In this statement, I address three aspects where I see deficiencies in the analysis supporting the Proposed Rule presented by the SEC: (1) the definition or characterization of investment risk, (2) the risks and returns associated with fixed indexed annuities compared with traditional fixed annuities, and (3) the suitability of fixed indexed annuities for seniors.

I. The Characterization of "Investment Risk" in the Proposed Rule

The definition or characterization of "risk" appears to be central to the SEC's analysis regarding the Proposed Rule. It is important to be clear regarding what constitutes the kinds of risk important to FIA owners and to distinguish this from the kind of risk to which the Proposed Rule 151A is directed.

The fundamental meaning of "risk" has undergone a slow evolution over time from its early Greek (Plato, 360 B.C.) and Latin (Tacitus, 109 A.D.) roots, but in large measure it has remained unchanged, focusing primarily on disaster, peril, danger, and hazard. Its etymology is discussed elsewhere (Cline, 2004). Fast forward 2,400 years and we find its primary meanings continue to define risk by reference to undesirable outcomes – the potential for loss. Today, the most common definitions of risk overwhelmingly remain associated with the existence of hazard, danger, peril, exposure to loss, pain, injury or destruction (e.g., *Webster's Revised Unabridged Dictionary*). In the *Merriam-Webster's Dictionary of Law*, the meaning is narrowed to: possibility of loss or injury; liability for loss or injury if it occurs; the chance of loss; and uncertainty with regard to loss. In the medical field, risk is associated with: the possibility of suffering a harmful event; a factor or course involving uncertain danger (*American Heritage Stedman's Medical Dictionary*); possibility of loss, injury, disease or death (*Merriam-Webster*

[1] Proposed Rule 151A under the Securities Act of 1933 (the "Proposed Rule").

[2] I will use the term "fixed indexed annuities," (or "FIAs") to refer to this product subsequently.

Medical Dictionary). Indeed, in the lexicon of 30 other languages, from Arabic to Swedish, the predominant meaning of the concept of "risk" is associated with the chance of something bad happening.

In the financial economics community, however, some have altered the meaning of risk to incorporate the potential for uncertain gain as well as loss – "the chance that an investment's actual return will be different than expected" (*Investopedia*). Broad definitions of this type have been criticized because, as knowledgeable investors know, for almost all securities the chance that their realized return will be different from the expected return approaches 100%. This is because the "different-from-expected" definition focuses only on the probability ("frequency" in insurance parlance) without regard to the magnitude ("severity" in insurance parlance) of the deviations from expected return. The focus on loss, however, remains central to the idea of investment risk for many in the finance community, as the entry in *Barron's Dictionary of Finance and Investment Terms 3rd Ed.* indicates where risk is defined as the "measurable possibility of losing or not gaining in value."

To the extent that some in the field of financial economics continue to use a characterization of investment risk that incorporates a consideration of upside potential as well as downside loss (both weighted equally), while the understanding of risk across other disciplines (as well as in common usage) focuses on bad outcomes, it is instructive to recognize how this unique financial economics definition came about and why it is not appropriate in most circumstances.

The early measures of investment risk clearly focused on loss or lower returns. For example, Irving Fisher (1906) characterized risk as "the chance of earnings falling below the interest-paying line." The economic literature made a distinction between risk and uncertainty in 1921 with the work of Frank Knight, who associated risk with deviations from the expected outcome where the probabilities and magnitudes are known, and uncertainty, where the probabilities and magnitudes are unknown (Knight, 1921). With the introduction of modern portfolio theory (Markowitz, 1950, 1952), the risk inherent in financial securities began to be measured by the calculation of the standard deviation of returns. This turn of events was motivated primarily by its mathematical tractability, although Markowitz admitted (1959) that a much better treatment of risk would focus on its semi-variance (downside variance).[3] Computers were in their nascent stages in those years and could more easily calculate the (complete) variance of a distribution rather than work through all the observations in a distribution to focus only on the downside risk. Hence, the association of the notion of risk with the mathematical calculation of variance (and standard deviation) was a compromise that at the time could be justified in terms of computational ease and efficiency, at the expense of a possible distortion of the concept of risk.

The use of the standard deviation as a measure of financial risk was embraced by Sharpe's Capital Asset Pricing Model (1964)[4] and, although today's computers can easily handle

[3] Markowitz received the Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel ("Nobel Prize in Economics") for his work in financial economics in 1990.

[4] Sharpe shared the 1990 Nobel Prize in Economics with Markowitz (and Merton M. Miller).

downside risk measures, two-sided measures of risk (incorporating upward and downward movements with equal weights) continue to be used in some quarters. Yet there are only two conditions under which these simple measures of two-sided risk (such as variance or standard deviation) correlate perfectly with downside risk, which captures what is more popularly considered risk: a Gaussian (i.e., "normal") distribution of rates of return, or a quadratic utility function for investors. However, there is now extensive economic literature showing that across almost all classes of securities, rate of return distributions are anything but Gaussian, and that quadratic utility functions are anything but rational and have been highly criticized by many of the most eminent economists of the last 50 years (Hicks, 1962; Arrow, 1963; Borch, 1969; Feldstein, 1969; Hirshleifer, 1970; Mao, 1970; Rothschild and Stiglitz, 1970; Hakansson, 1972).[5] It is noteworthy that in his seminal paper Markowitz (1950, p. 326) proposed to condense probability information in terms of moments and realized that the higher statistical moments may be relevant. Nevertheless, he limited himself to the mean and variance for the purposes of his analysis.

Today modern finance has progressed beyond those rudimentary risk measures and more sophisticated risk measures focus on downside loss, or the ratio of upward potential to downside loss. These measures of risk that have been developed during this "post-modern portfolio theory era" (Rom and Ferguson, 1994) are closer to the original concept and common understanding of risk that look toward the chance and magnitude of bad outcomes. "Upside risk" measures have not gained traction, except as potential reward measures in relation to loss measures (Sortino *et al*, 1999). Perhaps the best-known measure of downside risk in the investment literature is Roy's Safety First criterion (1952), which measures the chances of the investment value falling below some predefined disaster level. Other popular measures of risk aversion (which incorporate risk into utility theory) were developed by Arrow (1964, 1970) and Pratt (1964), both of which weigh losses more heavily in utility functions displaying any risk aversion.

Financial economists have since designed other more sophisticated measures to remedy the deficiencies associated with two-sided (and symmetric) risk measures such as standard deviation, variance and beta. These newer measures take into account the asymmetries and non-normality that typify asset returns. Early efforts focused on semi-variance rather than variance (Mao, 1970 and Markowitz 1959, 1970) as a measure of risk on the grounds that semi-variance concentrates on reducing losses, as opposed to variance which considers gains, as well as losses, as undesirable. Later risk measures took into account the entire probability distribution of returns. Having its origins in "majorization theory" (Hardy *et al.*, 1934) the extensive literature that treats investment decision-making by considering the entire distribution of returns is known as stochastic dominance (Quirk and Saposnik, 1962; Fishburn, 1964; Hadar and Russell, 1969; Hanoch and Levy, 1969; Levy, 1992; and Vickson, 1975, 1975, 1977; Whitmore and Findlay, 1978). Later works of Bawa (1975, and many subsequent works authored or co-authored by him), Fishburn (1977), Levy (2006) and others have refined the treatment of risk by focusing on the lower-partial moments of the distributions of returns. These risk measures return attention to

[5] Arrow and Stiglitz received the Nobel Prize in Economics in 1972 and 2001, respectively.

the loss measures that are consistent with popular understandings of risk. Examples of recent risk measures that take into account asymmetries in the return distribution and emphasize loss include the Sortino Ratio (Sortino and Van der Meer, 1991) the Leland measure (Leland, 1999), value-at-risk, conditional value-at-risk measures, and robust, "fat-tailed" measures of downside risk (Dutta and Perry, 2006). It is these measures that represent the state of art on risk measurement in the field of financial economics.

The use of models that emphasize the importance of investor loss aversion is confirmed by research in the emerging field of behavioral finance where such loss aversion behavior on the part of investors is clear and compelling. As stated by Sortino *et al.* (1999), "recent research in the behavioral finance area describes how investors want to behave. In general, investors do not seek the highest return for a given level of risk, as portfolio theory assumes. According to Shefrin and Statman (1998) investors seek upside potential with downside protection."

Given this backdrop of the development of concepts and measures of risk in the financial economics world, let me return to consider the core of the SEC's rationale for the Proposed Rule, which appears to be that: "When the amounts payable by an insurer under an indexed annuity are more likely than not to exceed the amounts guaranteed under the contract, the majority of the investment risk for the fluctuating, equity-linked portion of the return is borne by the individual purchaser, not the insurer." There are several problems with such an *ad hoc* standard, both in terms of its inconsistency with any accepted economic theory, its debatable calculation, and its perverse incentives.

As others have explained, FIAs are annuity contracts where purchasers receive a credit based on the positive performance of one or more equity or fixed income indexes (such as the S&P 500 Composite Stock Price Index™ or the Lehman Brothers Bond Index™). As a consequence of this structure, FIAs do not incur negative returns when the underlying equity or fixed income index for the fluctuating part of the return declines. FIAs do have minimum guaranteed values that increase each year <u>and</u> they have the <u>potential</u> to have higher (and only higher) values should the indexes move upward.

With regard to its consistency with economic theory, it is clear that the concept of risk permeating the Proposed Rule 151A analysis is focused on what economists have dubbed "upside potential," and not the "downside threat" – at least from the consumer's point of view. In other words, the SEC's stated concern appears to ignore the elimination of downside risk inherent in the FIAs and focuses solely on the uncertain amount of any upside potential to the consumer. This is a curious and improper way of looking at the situation. The individual FIA purchaser does not suffer any downside investment risk. That downside investment risk is entirely upon the shoulders of the guarantor, which in this case is the insurer. Essentially, the consumer has a contract with upside potential and a guarantee of principal. The insurer is "short" this position and the consumer's upside can be a potential loss to the insurer if it does not take steps to offset this risk. There are two general approaches that an insurer takes to meet its guarantees, which include providing a portion of the upside movement in the indexes to which the return formula is linked. The first approach is hedging through dynamic trading.

Under the dynamic trading approach, a portion of this risk can be hedged by the insurer through dynamically synthesizing options by taking multiple positions (typically seven) in index futures each trading day and rebalancing them on a daily basis, or more often, as necessary, according to a complex algorithm. In addition, this dynamic hedging approach requires the purchase of multiple interest rate caps, combined with the sale of interest rate floors, and a managed, laddered portfolio of zero-coupon bonds in order to meet its guarantees. Because there is no perfect hedge available, the insurer incurs much basis risk and uses its own capital to secure its promised returns. For a typical portfolio of FIAs, such an approach would entail more than 25,000 trades over a 15-year period. Compare this to the single payment of the consumer and it is apparent which party is shouldering the greater part of the investment risk!

An alternative approach to hedging the investment risk contained in FIAs is to enter into private contracts (because traded options do not adequately cover the contractual risks in FIAs) with third parties willing to manufacture and write options. Such specialized contracts are tedious to create and involve counterparty risk, as well as frequent updating as experience emerges with lapses, exercise of policy options, morbidity and mortality. The insurer may attempt to hedge a portion of the counterparty risk through individualized credit default swap contracts, or it may absorb the downside loss potential on its own by using its surplus capital. In either case, the basis risk arising from the unhedgeable elements of the FIA will have to be absorbed by the insurer.

A contract that offers the greater of a minimum guaranteed return each period or an indexed return will have a probability approaching 100% over time of generating a cumulative return that is greater than that guaranteed, provided that there is a "ratcheted" return provision in the contract. The SEC did not state that the calculation of its "more likely than not" threshold was a monthly, annual, or contract lifetime feature. The ratchet feature is common in almost all FIAs, which means that the consumer locks in any gains over multiple periods. A "risk measure" that categorizes virtually everything as being "more likely than not to exceed the amounts guaranteed under the contract" is analytically meaningless in such circumstances.

The SEC's Proposed Rule 151A would likely create perverse incentives to insurers that may wish to avoid yet another layer of regulation. If an insurer wants to be "under the wire" for regulatory purposes, it need do nothing more than adjust the parameters of its contracts going forward to ensure that nothing more than the minimum guaranteed return is ever credited. It is difficult to fathom that the intention in giving the SEC oversight in the regulation of securities was to protect consumers from any "upside potential" or to motivate financial institutions to adjust contracts so that consumers could not benefit from higher than minimum guaranteed returns.

Understanding the structure of FIAs makes two points immediately obvious. First, as discussed above, the only "investment risk" that the FIA purchaser accepts for the fluctuating portion of the FIA return is the "risk" of higher returns. The insurer either absorbs or hedges against the costs it will incur occasioned by the upward movement in the relevant indexes. Second, contrary to the presumption embedded in the analysis associated with the SEC's Proposed Rule 151A, the insurer retains significant amounts of "investment risk" in providing FIAs to consumers. The

SEC's ill-advised focus on only one facet of "investment risk" has blinded it to the larger investment risk profile, and the overall risk mitigation capabilities, of FIAs.

FIA premiums go into the selling insurers' general account, and the payments arising from FIAs come from the general account. The investment performance of the general account, therefore, is crucial when evaluating the overall risk inherent in FIAs. To the extent that the general account return performance is subpar, the insurer is at risk because the overall guarantees embedded in the FIAs must still be met. The analysis accompanying the SEC's Proposed Rule 151A ignores this reality. The risks the insurer retains in providing FIAs include: (1) the risk of capital loss as the general account assets lose value due to rising interest rates or declining stock prices, (2) the liquidity risk associated with both equities and fixed income securities, (3) the counterparty risk associated with swap and derivative positions, (4) and numerous other financial market and counterparty risks.

I note that the SEC's efforts to regulate overall market performance and the management and reporting of corporate finances is the primary benefit that it can provide to purchasers of FIAs. As FIAs' upside potential relies on indexes comprised of numerous individual securities (that are often traded on exchanges or in OTC markets), FIA providers have no ability to manipulate the index results. The SEC, however, through its regulatory capabilities devoted to fostering greater market efficiency and transparency, as well as good corporate management and reporting, benefits the purchasers of FIAs quite significantly.

This is an appropriate task for SEC enforcement and one, I contend, where the regulatory benefit/cost ratio will substantially exceed that associated with the regulation of indexed annuities. Regulating markets and corporate disclosures addresses systemic risks in the economy and is considerably more amenable to SEC regulation than the individualized characteristics of FIAs. It is important to note that FIAs are issued specific to each individual at a particular point in time. FIAs have numerous options that the purchaser can exercise, and the collection of options exercised by each purchaser specifically addresses the individualized needs and desires of that purchaser. Extending SEC regulation to such individually designed financial instruments could well involve the SEC in disputes where extremely particularized investigations would be needed to attain resolution. As a federal agency with national (and international) scope, SEC enforcement resources are likely better focused on more systemic issues.

II. Comparing Rates of Return Between FIAs and Traditional Fixed Annuities

To the best of my current knowledge, there is no comprehensive and competent examination in the public, peer-reviewed literature comparing the risk and return characteristics of FIAs and traditional fixed annuities. Nevertheless, examination of the crediting mechanisms / characteristics of these two products suggests that, over a long enough period of time, FIAs would likely yield a return notably higher than that available in an appropriately comparable traditional fixed annuity with only somewhat greater dispersion.

subjecting the owner to any surrender penalties. This is more than twice the withdrawal rate an individual can get through bond ownership in today's yield environment, without invading principal, and more than six times the level an individual can get through stock ownership at today's dividend levels, without being subject to market price losses. If an individual invades principal, she is subject to reverse dollar-cost-averaging, which means that she will have to sell more bonds or stocks when the market is down in order to achieve a particular income objective, and then will have fewer bonds or stocks to ride the market back up. The losses from reverse dollar-cost-averaging have proven to be substantial over the three to four business cycles that typically occur during a retirement phase. The losses are particularly pronounced if the individual enters into retirement at the beginning of a downward cycle. With annuity withdrawals or payouts, the individual is not subject to such risk. Based on historical figures, money that is expected to last more than 30 years in a stable market can become extinguished in fewer than 14 years if an individual is holding a portfolio of bonds (60%) and stock (40%) at retirement, or in fewer than 7 years if one has all of their savings in stock.

Deferred annuities, including the FIA contracts at issue in the Proposed Regulation, may be attractive vehicles for risk-averse or inexperienced investors. For inexperienced investors, or those unwilling or unable to extend the effort to trade their own portfolios, traditional and indexed annuities offer a low-risk and worry-free investment alternative. This is supported by the 2007 NAVA survey on Investment Risk and Guarantees, which indicates that large "segments of older Americans are open to products, such as annuities, that allow them to minimize their fears while investing in the stock market" (Matthew Greenwald, 2007, p.10).

Indexed annuities allow for some equity or fixed income market upside exposure, yet are suitable for senior citizens due to the embedded guarantees. The purchase of an indexed annuity can help to achieve a more remunerative investment strategy without subjecting invested funds to the losses associated with market downturns.

2) Protection from Outliving One's Assets

The need to protect against outliving one's assets has increased in recent years. The erosion of confidence in Social Security promises and adequacy of benefits, the accelerating demise of corporate pension programs,[7] the rising costs of healthcare, the erosion of retirement income occasioned by inflation, and an increasing American life expectancy have all contributed to a greater emphasis on private saving for retirement (Munnell, 2003).

As annuities were first developed to ensure that policyowners did not outlive their assets (Poterba, 1997), an annuity can be an important part of a retirement plan. A fixed annuity

[7] The number of defined contribution plans has risen from approximately 341,000 plans in 1980 to approximately 653,000 plans in 2004. Conversely, the number of defined benefit plans has decreased from approximately 148,000 plans to 47,000 plans over the same period. Refer to the "Facts" from Employee Benefit Research Institute, June 2007.

enables the annuitant to receive a steady, monthly payment during the annuity's liquidation phase for a desired amount of time, typically for the duration of the annuitant's life. A 2007 NAVA survey on Investment Risk and Guarantees indicated that guaranteed lifetime income is important to older Americans. "A large majority (82%) of older Americans feel that investments with guaranteed lifetime payments provide supplemental income and peace of mind" (Matthew Greenwald, 2007, p. 8).

One particular segment of the population at risk to outlive their assets is women. Married women generally outlive their husbands by six years (Babbel, 2008). Also, older women are 50% more likely than older men to live in poverty. A New York Life Insurance Company survey conducted in March 2006 found that "only 54% of women expressed confidence that they would be able to maintain their lifestyle after their husband's death" (Babbel, 2008, p.6). These data points emphasize that certain profiles within the population rely on products that provide guaranteed income and that can help offset increased medical expenditures.

Apart from inflation-indexed Social Security payments, many elderly people may be living on fixed incomes from pensions, immediate annuities, and interest income. It is impossible for economists to forecast inflation over the 20-35-year typical horizon of retirement with any accuracy, yet the elderly are especially vulnerable to the cumulative effects of inflation on the purchasing power of their fixed income.[8] Having one or more deferred annuities, particularly an annuity that increases in value as an index increases, allows a senior to continue accumulating assets in a safe (and tax-efficient) manner, so that when the need arises, it is available to be partially or wholly annuitized to supplement one's income.

Some of the FIAs under consideration for inclusion in the Proposed Rule offer an annuitant the ability to convert the contract to one of the settlement options including income for a specified period, for their lifetimes, and other annuitization options anytime after the first contract year.

3) Benefits from the Upside Potential of Equity or Fixed-Income Markets

One of the major attractions specific to FIAs is the ability of the purchaser to benefit from some of the upside potential of the equity or fixed-income markets while simultaneously eliminating all of the downside exposure to those markets and assuring a guaranteed stream of payments. Most seniors hope that they will have many years of enjoyable retirement. The benefit from the possible upward movements of the equity market (and elimination of the downward movements) is an attractive feature of FIAs for seniors looking at a long retirement period.

[8] For example, over each ten-year period since America abandoned the gold standard in January of 1972, inflation has eroded the value of fixed income payments by anywhere from 21% to 53%.

Seniors can, of course, get exposure to equity markets by investing in a well-diversified portfolio of mutual funds. Such a tactic, however, exposes them to drops in stock prices and the ravages of reverse dollar-cost-averaging described above. The more sophisticated can mitigate this risk by purchasing options or actively managing their portfolio(s). This approach, however, incurs costs and few (if any) seniors have the ability to manage their portfolios adequately over a long retirement period. Purchasing an FIA hands the responsibility for hedging against a downturn in the index to professional investors and, more importantly, the FIA provider guarantees that the purchaser never suffers the loss.

4) Benefits of Stability and Guaranteed Rates of Return

Recent research has shown that senior citizens generally earn about 2% less per year, on average, on their stock and bond portfolios than people below 55 years in age, even after adjusting for the riskiness of the portfolios (Korniotis and Kumar, 2007). This can have a large cumulative negative effect upon the amount of capital available to provide income for one's later years, and when people compare annuity returns to what can be earned in alternative investments they need to account for this fact. With an FIA, one gets the benefit of more stable asset growth than that available through many other methods, with protection against negative returns. Few, if any, individuals can replicate guaranteed rates of return of an FIA over a long period of time without taking notable downside risk.

5) Nursing Home Care

One of the risks of the elderly is incurring the expense of nursing home care. The annual cost of a private room averaged $75,000 in 2007. Consider an elderly person who is getting by with about $37,500 per year on a fixed income. When the need for nursing home care arises, such a person may not be able to afford it without going onto the welfare rolls, and would have to seek Medicaid and whatever levels of care such a program would support. Medicare does not cover such expenses. A person could plan for this through long-term care insurance, if there was enough foresight to have purchased it long prior to the need. However, the person may not wish to spend the money on insurance coverage that may never be needed. A person could purchase a step-up immediate annuity at the onset of retirement at 65 years of age, which would increase payments from $37,500 per year to $75,000 at some pre-specified date, such as 85 years of age. But what if the person guesses wrong about the age that such coverage will ultimately be needed? And what if the person guesses wrong about the amount that such coverage will ultimately cost 20 years later? And what if the person never needs the coverage, having died before nursing home care was required? A deferred annuity, including one that provides benefits associated with the upside movement in equity or fixed income markets, provides a good way to hedge against these risks.

Most FIAs provide a nursing care provision that allows between 20% and 100% withdrawals without any penalty, regardless of when the need arises after the first anniversary of the policy. Many FIAs also have a terminal illness rider available. A person can deduct the amount that is greater than 7.5% of her adjusted gross income, which would typically be the case for people undergoing nursing home care. The costs of qualified long-term care services can generally be included as medical expenses. Accordingly, the money placed in a deferred FIA will escape taxation during the accumulation phase, and if used for nursing home care, may ultimately escape it altogether. Should such care not be needed, the accumulated funds may be used for other purposes, such as conversion into an immediate annuity or a period-certain annuity. In either case, the annuitant benefits from an exclusion ratio that exempts from taxation a portion of each payment related to the basis of the contract and period over which it is expected to be returned. In the interim, the funds continue to accumulate tax-deferred interest until they are fully expended, in the case of a period-certain annuity, or until death in the case of a life annuity. Contrast this with an alternative non-qualified savings plan for such eventualities as nursing home care. The funds would be taxable throughout the accumulation period, and the amount of funds would typically be subject to capital losses that could jeopardize the individual at the time nursing home care is required.

6) Protection of Assets from Creditors or Fraud

One of the great fears of the elderly is that someone will obtain control of their assets and that they will lose their financial security without recourse to additional earning power. The elderly who have easily accessible, fully liquid assets are more prone to having someone abscond with their money, whether it be a related or unrelated party. In the case of a related party, who is assisting an aged person with daily living skills, the aged person is particularly vulnerable to emotional pressure to transfer assets with the implicit or explicit threat that care will be withheld if such transfer is not effected. Annuities are protected from creditors in most states, and the procedures involved in liquidating a portion or all of an annuity in order to meet an unwise disposal of their assets serves as a deterrent. A surrender penalty may be involved, as well as a delay of a month or so. This interval will relieve pressure on the aged person to transfer assets for such unwise purposes.

7) Tax Deferral

The classic approach taken by financial planners is to encourage tax deferral until one reaches a lower tax bracket at retirement. In today's uncertain tax environment, where certain tax preferences are scheduled to expire, an election is approaching, and a growing federal deficit, it cannot reasonably be assumed that tax rates will remain the same, or that one will slide into a lower tax bracket as one ages. Therefore, it is prudent to leave some flexibility in the timing of the realization of taxable income.

Research has demonstrated that for a person who purchases a deferred annuity at age 65 or beyond, the tax deferral benefit on a deferred annuity that is later converted (or exchanged) into an immediate annuity can exceed 200 basis points per year. In other words, for an alternative set of assets to produce a similar amount of after-tax income, they would need to generate more than 2% higher pre-tax return per year than the yield on an annuity. Several conditions affect the size of this tax benefit, including prevailing yields, length of time the annuity remains in deferral, length of remaining life, and the composition of the alternative portfolio among assets that generate capital gains, dividends, and ordinary income.

8) Avoidance of Probate Delays and Disclosures

Some people purchase deferred annuities as a convenient method of wealth transfer, in case the assets are not needed to provide for lifetime income. If one annuitizes the wealth at the onset of retirement, there may be nothing to transfer to one's heirs upon death.

The probate process can take a great deal of time. The settlement time frame for many estates is from nine months to two years. Complex or contested estates can take much longer. With few exceptions, your heirs will have to wait until probate is concluded to receive the bulk of their inheritance. Depending on the state, probate and administrative fees can consume between 6 and 10 percent of your estate. That percentage is calculated before any deductions or liens are taken out.

Privacy is an important issue for many people, especially as it pertains to their financial matters. Probated wills are public documents, but life insurance and annuity polices are private contracts. They do not have to be mentioned in a will and do not normally pass through probate. As a result, life insurance and annuity policies can be used to pass along assets with the utmost confidentiality and privacy intact.

Selected Bibliography

Arrow, K.J. (1963) "Comment." *Review of Economics and Statistics* 45:1, 24-27.

Arrow, K. G. (1970) "The role of securities in the optimal allocation of risk bearing." *Review of Economic Studies*.

Arrow, K. G. (1970) *Essays of the Theory of Risk-Bearing*. North-Holland: Amsterdam.

Babbel, D. F. (2008) "Lifetime Income for Women: A financial economist's perspective." Wharton Financial Institutions Center Policy Brief.

Bawa, V. S. (1975) "Optimal rules for ordering uncertain prospects." *Journal of Financial Economics* 2:1, 95-121.

Borch, K. (1969) "A note on uncertainty and indifferent curves." *Review of Economic Studies* 36:1, 1-4.

Cline, P. B. (2004) "The Etymology of Risk." Mimeo, Harvard University.

De Groot, J. S. (1998) "Behavioral Aspects of Decision Models in Asset Management." Labyrint Publication, Groningen University, The Netherlands, 1998.

Dutta, K. and Perry J. (2006) "A tale of tails: An empirical analysis of loss distribution models for estimating operational risk capital." Federal Reserve Bank of Boston Working Paper No. 06-13.

Feldstein, M. S. (1969) "Mean-variance analysis in the theory of liquidity preference and portfolio selection." *Review of Economic Studies* 36:1 5-12.

Fishburn, P. C. (1964) *Decision and Value Theory*. Wiley: New York.

Fishburn, P. C. (1977) "Mean-risk analysis with risk associated with below-target returns." *American Economic Review* 67:2, 116-26.

Fisher, I. (1906) *The Nature of Capital and Income*. Macmillan: New York.

Hadar, J. and Russel, W.R. (1969) "Rules for ordering uncertain prospects," *American Economic Review* 59:1, 25-34.

Hakansson, N. (1972) "Mean-variance analysis in a finite world." *Journal of Financial and Quantitative Analysis* 7:4, 1873-1880.

Hall, D. C. (2002) "What is 'risk'?" Greenbelt, MD, SRS Information Services Inc.: 12.

Hanoch, G., Levy, H. (1969) "The efficiency analysis of choices involving risk." *Review of Economic Studies* 36:3, 335-346.

Hardy, G. H., Littlewood, J. E., Pólya, G. (1934). *Inequalities*. Cambridge University Press: Cambridge, MA.

Hicks, J.R. (1962) "Liquidity" *Economic Journal* 72:288, 787-802.

Hirshleifer, J. (1970) *Investment, interest and capital*. Prentice Hall: Englewood cliffs, N.J.

Kaplan, S. (1997) "The words of risk analysis." *Risk Analysis* 17:4, 407-417.

Knight, F. H. (1921) *Risk Uncertainty, and Profit*. Hart, Schaffner & Marx: Boston MA.

Korniotis, G. and Kumar, A. (2007) "Does Investment Skill Decline due to Cognitive Aging or Improve with Experience?" Working Paper, Board of Governors of the Federal Reserve System and University of Texas at Austin.

Leland, H. (1999) "Beyond Mean-Variance: Risk and Performance Measurement in a Nonsymmetrical World." *Financial Analysts Journal* 54:1, 27-36.

Levy, H. (1992) "Stochastic dominance and expected utility: Survey and analysis. *Management Science* 38:4, 555-593.

Levy, H. (2006) *Stochastic Dominance: Investment Decision-Making under Uncertainty* Springer-Verlag: New York.

Selected Bibliography (continued)

Mao, J. C. T. (1970) "Models of capital budgeting. E-V vs. E-S." *Journal of Financial and Quantitative Analysis* 5:4, 657-675.

Markowitz, H. M. (1950) "Theories of uncertainty and financial behavior." *Econometrica* 19 (Chicago Meeting Report) 325-326.

Markowitz, H. M. (1952) "Portfolio selection." *Journal of Finance* 7:1, 77-91.

Markowitz, H. M. (1959) *Portfolio Selection.* Wiley: New York.

Mathew Greenwald & Associates, Inc. (2007) "2007 NAVA Survey on Investment Risk and Guarantees."

Munnell, A. H. (2003) "The Declining Role of Social Security." *Just the Facts on Retirement Issues*, Number 6, Center for Retirement Research at Boston College.

Ogryczak, W., Ruszczynski , A. (1999) "From stochastic dominance to mean-risk models: Semideviations as risk measures." *European Journal of Operational Research* 116:1, 33-50.

Poterba, J.M. (1997) "The History of Annuities in the United States." Working Paper 6001, National Bureau of Economic Research, 7-8.

Pratt, J. W. (1964) "Risk aversion in the small and in the large." *Econometrica* 32:1-2, 122-136.

Quirk, J. P. and Saposnik, R. "Admissibility and measurable utility functions." *Review of Economic Studies* 29:1, 140-146.

Rom, B. M. and Ferguson, K. W. (1994) "Post-modern portfolio theory comes of age." *Journal of Investing,* Fall 11-17.

Rothschild, M., Stiglitz, J. E. (1970) "Increasing risk: I. A definition." *Journal of Economic Theory* 2:3, 225-243.

Roy, A. D. (1952) "Safety first and the holding of assets." *Econometrica,* 431- 449.

Sharpe, W.F. (1964) "Capital asset prices: A theory of market equilibrium under conditions of risk." *Journal of Finance* 19:3, 425-442.

Sharpe, W.F. (1994) "The Sharpe Ratio." *Journal of Portfolio Management* 21:1, 49-58.

Shefrin, H. (2000) *Beyond Greed and Fear: Understanding Behavioral Finance and the Psychology of Investing.* Harvard Business School Press.

Sortino, F. A. and van der Meer, R. (1991) "Downside risk." *The Journal of Portfolio Management* 17(4), 27-31.

Sortino, F. A., van der Meer, R., Plantinga, A., and Forsey, H. (1999) "The Dutch Triangle." Pensions and Investments Magazine, September 26, 22.

Vickson, R. G. (1975) "Stochastic dominance for decreasing absolute risk aversion." *Journal of Financial and Quantitative Analysis* 10:4:799-811.

Vickson, R. G. (1975) "Stochastic dominance tests for decreasing absolute risk aversion I." *Management Science* 21, 1438-1496.

Vickson, R. G. (1977) "Stochastic dominance tests for decreasing absolute risk aversion II." *Management Science* 23, 478-489.

Whitmore, G. A, Findlay, M. C. (Eds.) (1978) *Stochastic Dominance: An Approach to Decision-Making Under Risk.* Heath: Lexington, MA.

INTERNATIONAL

MARK F. MEYER

Vice President

Ph.D. Economics,
University of Michigan

B.S.F.S. International Economics,
Georgetown University

Dr. Mark F. Meyer has over twenty years of experience applying economic theory and quantitative methods to a range of complex business litigation and regulatory matters. Dr. MeyerÕs experience includes assessing liability and damages for litigations involving firms engaged in financial markets, especially insurance; investigations of insurer insolvencies; antitrust analysis of monopolization, mergers, and price discrimination in a wide range of industries; work in the economics of product distribution and marketing; analysis of regulatory initiatives involving insurance and other industries; and statistical and econometric applications to liability determination, market definition, class certification, and economic damages.

Prior to joining CRA International, Dr. Meyer was a senior economist at the Princeton Economics Group, Inc., senior managing economist and a director in the New York office of the Law & Economics Consulting Group, Inc., and an economist at the law firm of Skadden, Arps, Slate, Meagher & Flom in New York.

PROFESSIONAL HISTORY

2008ÐPresent	*Vice President*, CRA International, New York, NY
2000Ð2008	*Senior Economist*, Princeton Economics Group, Inc., Princeton, NJ
1994Ð2000	*Senior Managing Economist, Director of New York Office*, Law & Economics Consulting Group, Inc., New York, NY
1987Ð1994	*Economist*, Skadden, Arps, Slate, Meagher & Flom, New York, NY
1982Ð1983	*Instructor: Business and Government*, Undergraduate School of Business Administration, The University of Michigan, Ann Arbor, MI
1982Ð1983	*Teaching Assistant: Econometrics, Institute of Public Policy Studies*, The University of Michigan, Ann Arbor, MI
1976Ð1979	*Economist and Manager*, Data Resources, Inc., Washington, DC

EXHIBITS

<u>Index Of Exhibits</u>

Coalition Of Indexed Products

Comment Regarding Proposed Rule 151A

Exhibit	Description
A	Comparison of guarantees for indexed annuities versus fixed rate annuities.
B	Buyer's Guide to Fixed Deferred Annuities With Appendix For Equity-Indexed Annuities, National Association of Insurance Commissioners
C	Sample fixed indexed annuity marketing materials.
D	Sample fixed indexed annuity disclosure statement.
E	Sample fixed indexed annuity suitability statements.

Exhibit A
Comparison Of Guaranteed Cash Surrender Values
Fixed Indexed Annuities v. Fixed Annuities
Actual Figures For Anonymous Coalition Member

Top 5 Index Annuities In 2005						
Form No.	**Premiums YTD 6/30/05**	**1st Year Bonus**	**Minimum Guaranteed Cash Surrender Values**			
			1st Year	**2nd Year**	**5th Year**	**10th Year**
Index 1	$ 513,485,000	10%	$ 89,980	$ 92,004	$ 98,355	$ 109,929
Index 2	353,173,000		87,974	91,054	100,953	117,032
Index 3	275,639,000	7.5%	90,682	92,723	99,124	110,788
Index 4	94,350,000		93,150	96,410	106,891	123,916
Index 5	30,233,000	2%	95,790	98,663	111,290	126,328
	$ 1,266,880,000					

Top 2 Fixed Rate Annuities And 2 Other Products						
Form No.	**Premiums YTD 6/30/05**	**1st Year Bonus**	**Minimum Guaranteed Cash Surrender Values**			
			1st Year	**2nd Year**	**5th Year**	**10th Year**
FPDA 1	$ 36,659,000	2%	$ 87,935	$ 89,913	$ 99,473	$ 117,425
FPDA 2	14,194,000	6%	87,935	89,913	99,473	117,425
FPDA 3	353,000	2%	89,649	92,687	100,646	120,457
FPDA 4	154,000	6%	93,165	95,215	105,184	123,863
	$ 51,360,000					

BUYER'S GUIDE TO FIXED DEFERRED ANNUITIES WITH APPENDIX FOR EQUITY-INDEXED ANNUITIES

Prepared by the

NAIC

National Association of Insurance Commissioners

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various insurance departments to coordinate insurance laws for the benefit of all consumers.

This guide does not endorse any company or policy.

Reprinted by...

OM Financial Life Insurance Company

FGLI4898 (10-2002)

HOW ARE THE INTEREST RATES SET FOR MY FIXED DEFERRED ANNUITY?

During the accumulation period, your money (less any applicable charges) earns interest at rates that change from time to time. Usually, what these rates will be is entirely up to the insurance company.

CURRENT INTEREST RATE

The current rate is the rate the company decides to credit to your contract at a particular time. The company will guarantee it will not change for some time period.

The initial rate is an interest rate the insurance company may credit for a set period of time after you first buy your annuity. The initial rate in some contracts may be higher than it will be later. This is often called a bonus rate.

The renewal rate is the rate credited by the company after the end of the set time period. The contract tells how the company will set the renewal rate, which may be tied to an external reference or index.

MINIMUM GUARANTEED RATE

The minimum guaranteed interest rate is the lowest rate your annuity will earn. This rate is stated in the contract.

MULTIPLE INTEREST RATES

Some annuity contracts apply different interest rates to each premium you pay or to premiums you pay during different time periods.

Other annuity contracts may have two or more accumulated values that fund different benefit options. These accumulated values may use different interest rates. You get only one of the accumulated values depending on which benefit you choose.

WHAT CHARGES MAY BE SUBTRACTED FROM MY FIXED DEFERRED ANNUITY?

Most annuities have charges related to the cost of selling or servicing it. These charges may be subtracted directly from the contract value. Ask your agent or the company to describe the charges that apply to your annuity. Some examples of charges, fees and taxes are:

SURRENDER OR WITHDRAWAL CHARGES

If you need access to your money, you may be able to take all or part of the value out of your annuity at any time during the accumulation period. If you take out part of the value, you may pay a withdrawal charge. If you take out all of the value and surrender, or terminate, the annuity, you may pay a surrender charge. In either case, the company may figure the charge as a percentage of the value of the contract, of the premiums you've paid or of the amount you're withdrawing. The company may reduce or even eliminate the surrender charge after you've had the contract for a stated number of years. A company may waive the surrender charge when it pays a death benefit.

Some annuities have stated terms. When the term is up, the contract may automatically expire or renew. You're usually given a short period of time, called a window, to decide if you want to renew or surrender the annuity. If you surrender during the window, you won't have to pay surrender charges. If you renew, the surrender or withdrawal charges may start over.

In some annuities, there is no charge if you surrender your contract when the company's current interest rate falls below a certain level. This may be called a bail-out option.

In a multiple-premium annuity, the surrender charge may apply to each premium paid for a certain period of time. This may be called a rolling surrender or withdrawal charge.

Some annuity contracts have a market value adjustment feature. If interest rates are different when you surrender your annuity than when you bought it, a market value adjustment may make the cash surrender value higher or lower. Since you and the insurance company share this risk, an annuity with a MVA feature may credit a higher rate than an annuity without that feature.

Be sure to read the Tax Treatment section and ask your tax advisor for information about possible tax penalties on withdrawals.

FREE WITHDRAWAL

Your annuity may have a limited free withdrawal feature. That lets you make one or more withdrawals without a charge. The size of the free withdrawal is often limited to a set percentage of your contract value. If you make a larger withdrawal, you may pay withdrawal charges. You may lose any interest above the minimum guaranteed rate on the amount withdrawn. Some annuities waive withdrawal charges in certain situations, such as death, confinement in a nursing home or terminal illness.

CONTRACT FEE

A contract fee is a flat dollar amount charged either once or annually.

TRANSACTION FEE

A transaction fee is a charge per premium payment or other transaction.

you withdraw the money. You may also have to pay a 10% tax penalty if you withdraw the accumulation before age 59 ½. The Internal Revenue Code also has rules about distributions after the death of a contract holder.

Annuities used to fund certain employee pension benefit plans (those under Internal Revenue Code Sections 401(a), 401(k), 403(b), 457 or 414) defer taxes on plan contributions as well as on interest or investment income. Within the limits set by the law, you can use pretax dollars to make payments to the annuity. When you take money out, it will be taxed.

You can also use annuities to fund traditional and Roth IRAs under Internal Revenue Code Section 408. If you buy an annuity to fund an IRA, you'll receive a disclosure statement describing the tax treatment.

WHAT IS A "FREE LOOK" PROVISION?

Many states have laws which give you a set number of days to look at the annuity contract after you buy it. If you decide during that time that you don't want the annuity, you can return the contract and get all your money back. This is often referred to as a free look or right to return period. The free look period should be prominently stated in your contract. Be sure to read your contract carefully during the free look period.

HOW DO I KNOW IF A FIXED DEFERRED ANNUITY IS RIGHT FOR ME?

The questions listed below may help you decide which type of annuity, if any, meets your retirement planning and financial needs. You should think about what your goals are for the money you may put into the annuity. You need to think about how much risk you're willing to take with the money. Ask yourself:

- How much retirement income will I need in addition to what I will get from Social Security and my pension?
- Will I need that additional income only for myself or for myself and someone else?
- How long can I leave my money in the annuity?
- When will I need income payments?
- Does the annuity let me get money when I need it?
- Do I want a fixed annuity with a guaranteed interest rate and little or no risk of losing the principal?
- Do I want a variable annuity with the potential for higher earnings that aren't guaranteed and the possibility that I may risk losing principal?
- Or, am I somewhere in between and willing to take some risks with an equity-indexed annuity?

WHAT QUESTIONS SHOULD I ASK MY AGENT OR THE COMPANY?

- Is this a single premium or multiple premium contract?
- Is this an equity-indexed annuity?
- What is the initial interest rate and how long is it guaranteed?
- Does the initial rate include a bonus rate and how much is the bonus?
- What is the guaranteed minimum interest rate?
- What renewal rate is the company crediting on annuity contracts of the same type that were issued last year?
- Are there withdrawal or surrender charges or penalties if I want to end my contract early and take out all of my money? How much are they?
- Can I get a partial withdrawal without paying surrender or other charges or losing interest?
- Does my annuity waive withdrawal charges for reasons such as death, confinement in a nursing home or terminal illness?
- Is there a market value adjustment (MVA) provision in my annuity?
- What other charges, if any, may be deducted from my premium or contract value?
- If I pick a shorter or longer payout period or surrender the annuity, will the accumulated value or the way interest is credited change?
- Is there a death benefit? How is it set? Can it change?
- What income payment options can I choose? Once I choose a payment option, can I change it?

FINAL POINTS TO CONSIDER

Before you decide to buy an annuity, you should review the contract. Terms and conditions of each annuity contract will vary.

Ask yourself if, depending on your needs or age, this annuity is right for you. Taking money out of an annuity may mean you must pay taxes. Also, while it's sometimes possible to transfer the value of an older annuity into a new annuity, the new annuity may have a new schedule or charges that could mean new expenses you must pay directly or indirectly.

You should understand the long-term nature of your purchase. Be sure you plan to keep an annuity long enough so that the charges don't take too much of the money you put in. Be sure you understand the effect of all charges.

If you're buying an annuity to fund an IRA or other tax-deferred retirement program, be sure that you're eligible. Also, ask if there are any restrictions connected with the program.

Remember that the quality of service that you can expect from the company and the agent is a very important factor in your decision.

Some annuities may put an upper limit, or cap, on the index-linked interest rate. This is the maximum rate of interest the annuity will earn. In the example given above, if the contract has a 6% cap rate, 6%, and not 6.3%, would be credited. Not all annuities have a cap rate.

FLOOR ON EQUITY INDEX-LINKED INTEREST

The floor is the minimum index-linked interest rate you will earn. The most common floor is 0%. A 0% floor assures that even if the index decreases in value, the index-linked interest that you earn will be zero and not negative. As in the case of a cap, not all annuities have a stated floor on index-linked interest rates. But in all cases, your fixed annuity will have a minimum guaranteed value.

AVERAGING

In some annuities, the average of an index's value is used rather than the actual value of the index on a specified date. The index averaging may occur at the beginning, the end, or throughout the entire term of the annuity.

INTEREST COMPOUNDING

Some annuities pay simple interest during an index term. That means index-linked interest is added to your original premium amount but does not compound during the term. Others pay compound interest during a term, which means that index-linked interest that has already been credited also earns interest in the future. In either case, however, the interest earned in one term is usually compounded in the next.

MARGIN/SPREAD/ADMINSTRATIVE FEE

In some annuities, the index-linked interest rate is computed by subtracting a specific percentage from any calculated change in the index. The percentage, sometimes referred to as the "margin," "spread," or "administrative fee," might be instead of, or in addition to, a participation rate. For example, if the calculated change in the index is 10%, your annuity might specify that 2.25% will be subtracted from the rate to determine the interest rate credited. In this example, the rate would be 7.75% (10% - 2.25% = 7.75%). In this example, the company subtracts the percentage only if the change in the index produces a positive interest rate.

VESTING

Some annuities credit none of the index-linked interest or only part of it, if you take out all your money before the end of the term. The percentage that is vested, or credited, generally increases as the term comes closer to its end and is always 100% at the end of the term.

HOW DO THE COMMON INDEXING METHODS DIFFER?

ANNUAL RESET

Index-linked interest, if any, is determined each year by comparing the index value at the end of the contract year with the index value at the start of the contract year. Interest is added to your annuity each year during the term.

HIGH-WATER MARK

The index-linked interest, if any, is decided by looking at the index value at various points during the term, usually the annual anniversaries of the date you bought the annuity. The interest is based on the difference between the highest index value and the index value at the start of the term. Interest is added to your annuity at the end of the term.

LOW-WATER MARK

The index-linked interest, if any, is determined by looking at the index value at various points during the term, usually the annual anniversaries of the date you bought the annuity. The interest is based on the difference between the index value at the end of the term and the lowest index value. Interest is added to your annuity at the end of the term.

POINT-TO-POINT

The indexed-linked interest, if any, is based on the difference between the index value at the end of the term and the index value at the start of the term. Interest is added to your annuity at the end of the term.

WHAT ARE SOME OF THE FEATURES AND TRADE-OFFS OF DIFFERENT INDEXING METHODS?

FEATURES

ANNUAL RESET

Since the interest earned is "locked in" annually and the index value is "reset" at the end of each year, future decreases in the index will not affect the interest you have already earned. Therefore, your annuity using the annual reset method may credit more interest than annuities using other methods when the index fluctuates up and down often during the term. This design is more likely than others to give you access to index-linked interest before the term ends.

HIGH-WATER MARK

Since interest is calculated using the highest value of the index on a contract anniversary during the term, this design may credit higher interest than some other designs if the index reaches a high point early or in the middle of the term, then drops off at the end of the term.

LOW-WATER MARK

Since interest is calculated using the lowest value of the index prior to the end of the term, this design may credit higher interest than some other designs if the index reaches a low point early or in the middle of the term and then rises at the end of the term.

HOW DO I KNOW IF AN EQUITY-INDEXED ANNUITY IS RIGHT FOR ME?

The questions listed below may help you decide which type of annuity, if any, meets your retirement planning and financial needs. You should consider what your goals are for the money you may put into the annuity. You need to think about how much risk you're willing to take with the money. Ask yourself:

- Am I interested in a variable annuity with the potential for higher earnings that are not guaranteed and willing to risk losing the principal?
- Is a guaranteed interest rate more important to me, with little or no risk of losing the principal?
- Or, am I somewhere in between these two extremes and willing to take some risks?

HOW DO I KNOW WHICH EQUITY-INDEXED ANNUITY IS BEST FOR ME?

As with any other insurance product, you must carefully consider your own personal situation and how you feel about the choices available. No single annuity design may have all the features you want. It is important to understand the features and trade-offs available so you can choose the annuity that is right for you. Keep in mind that it may be misleading to compare one annuity to another unless you compare all the other features of each annuity. You must decide for yourself what combination of features makes the most sense for you. Also remember that it is not possible to predict the future behavior of an index.

QUESTIONS YOU SHOULD ASK YOUR AGENT OR THE COMPANY

You should ask the following questions about equity-indexed annuities in addition to the questions in the Buyer's Guide to Fixed Deferred Annuities.

- How long is term?
- What is the guaranteed minimum interest rate?
- What is the participation rate? For how long is the participation rate guaranteed?
- Is there a minimum participation rate?
- Does my contract have an interest rate cap? What is it?
- Does my contract have an interest rate floor? What is it?
- Is interest rate averaging used? How does it work?
- Is interest compounded during a term?
- Is there a margin, spread, or administrative fee? Is that in addition to or instead of a participation rate?
- What indexing method is used in my contract?
- What are the surrender charges or penalties if I want to end my contract early and take out all of my money?
- Can I get a partial withdrawal without paying charges or losing interest? Does my contract have vesting? If so, what is the rate of vesting?

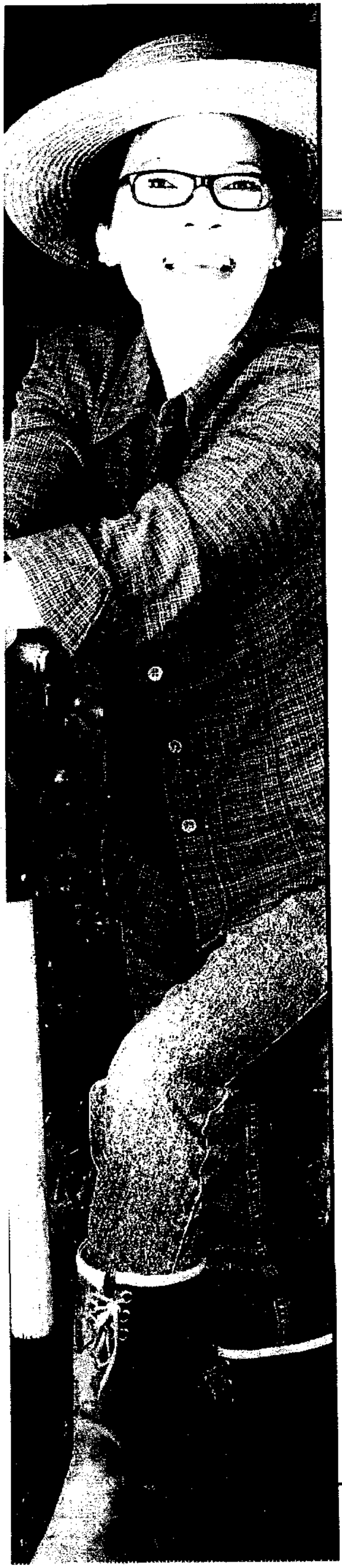
FINAL POINTS TO CONSIDER

Remember to read your annuity contract carefully when you receive it. Ask your agent or insurance company to explain anything you don't understand. If you have a specific complaint or can't get answers you need from the agent or company, contact your state insurance department.

American Equity's Gold standard for a secure Retirement

Bonus Gold

(INDEX-1-07)*



Where Will Your Retirement Dollars Take You?

RETIREMENT PROTECTION

ASSURING YOUR LIFESTYLE...

As Americans, we work hard everyday to earn an income to take care of our families, educate our children and provide for a secure retirement. As retirement age approaches, we are wise to consider:

- **Are Our Retirement Dollars Safe?**
- **How Will Taxes Affect Our Standard of Living?**
- **What Happens To My Family if I Become Ill?**
- **Do We Have Enough Money to Retire?**

INDEXED ANNUITIES FOR YOUR RETIREMENT PORTFOLIO

Indexed annuities are fixed annuities that provide an opportunity to potentially earn more interest than traditional fixed annuities and other safe money alternatives. This is done by basing interest earned on an increase in an equity or bond index. You control how your annuity grows by choosing the index crediting methods on each Contract Anniversary. The most commonly used indices are:

- S&P 500®
- Dow Jones Industrial Average℠
- Lehman Brothers U.S. Aggregate

A very important benefit is that your premium and credited interest can never be lost due to index volatility.

When purchasing an indexed annuity, you own an annuity Contract backed by American Equity Investment Life Insurance Company, you are not purchasing shares of stock or indexes.

BENEFITS OF ANNUITIES

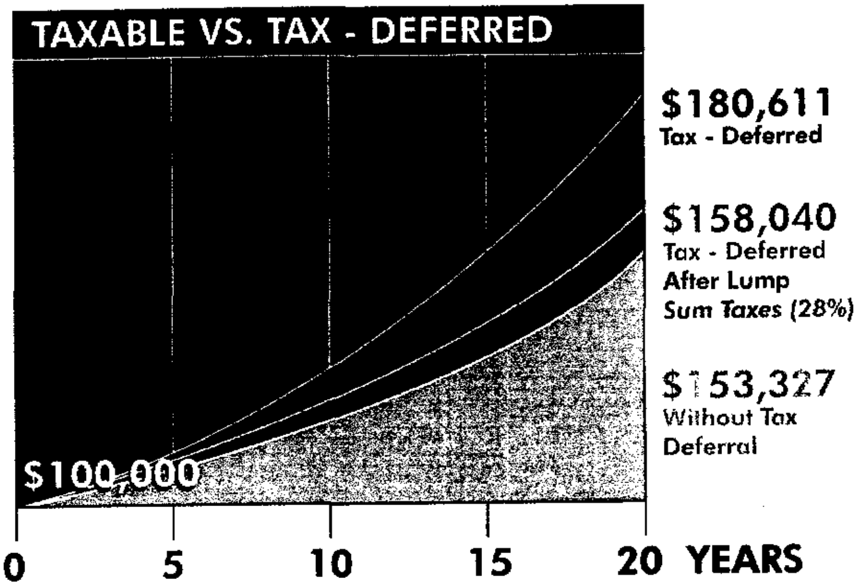
At American Equity, our innovative tax deferred annuities help you maximize both growth and safety for your hard earned retirement dollars, ultimately offering you the peace of mind you deserve. We understand that creating a retirement nest egg is hard work and while many people take into consideration market risk, there are five other factors you should consider as well:

- Safety Of Premium
- Income Taxes
- Avoidance Of Probate
- Liquidity
- Guaranteed Income

SAFETY OF PREMIUM

Fixed annuities by their very nature are considered a safe money alternative. It is a contract between you and the insurance company for guaranteed interest and guaranteed income options.

American Equity insures this safety by investing your premium dollars in a diversity of investments that are closely regulated by state insurance departments. These long-term investments ensure the stability of the company and help to provide you with a competitive yield.



Note: Example assumes 3% annual interest rate and 28% tax bracket.

INCOME TAXES

One of the primary advantages of deferred annuities is the opportunity to accumulate a substantial sum of money by **allowing your premium and interest to grow tax-deferred. Unlike taxable investments, you pay no taxes on your annuity interest until you begin to take withdrawals or receive income.** This allows your money to grow faster than in a taxable account. With our annuities you earn interest on your premium, interest on your interest and interest on what you would normally pay in income taxes.

The chart above illustrates how much more your money grows over a 20-year period with a tax-deferred annuity compared to an account that is currently taxed.

AVOIDANCE OF PROBATE

In the case of premature death, your beneficiaries have the accumulated funds within your annuity available to them and may avoid the expense, delay and publicity of probate. Your named beneficiaries can choose to receive the proceeds as monthly income or a lump sum payment.

LIQUIDITY

American Equity provides you with opportunities to withdraw funds at any time (subject to applicable surrender charges). Our contracts allow penalty-free withdrawals of up to 10%, after the first contract anniversary. American Equity also has available certain riders which increase liquidity in the event of confinement to a nursing home, or if diagnosed with a terminal illness. (Riders not available in all states.)

GUARANTEED INCOME

American Equity can provide you with a guaranteed income from this tax-deferred annuity. You have the ability to choose from several different income options, including payments for a specified number of years or income for life, no matter how long you live.

Is Protection from Losses Important to You?

The Bonus Gold: Choices & Diversification

	Annual Monthly Average	Annual Point to Point
Interest Credit Calculation	Average sum of index closes on monthly Contract Anniversary	Percentage of annual increase in the Index
Index Availability	S&P 500®, DJIA℠	S&P 500®, DJIA℠, & Lehman Brothers Bond
Frequency of Interest Credit	Annually	Annually
Cap, AFR or Participation Rate Available	Choice of Cap & AFR or Participation Rate* *Provided by MA-PR Rider on S&P 500® only.	Choice of Cap & AFR or Participation Rate* *Provided by APT-PR Rider on S&P 500® on

TRUE DIVERSIFICATION

American Equity annuities offer 9 Interest Crediting Methods using 3 different Indexes for choices and flexibility. American Equity is one of only a few companies offering both bond and equity based interest-crediting methods.

INDEX CHOICES

- **The S&P 500® Index** contains Stocks from 500 various industry leaders and is widely regarded as the premier benchmark for U.S. stock market performance.

- **Dow Jones Industrial Average℠** is the oldest continuing stock market index in the world. Many of the stocks represented in the DJIA℠ are leaders in their industries.

- **Lehman Brothers U.S. Aggregate Index** is a U.S. dollar denominated index made up of fixed rate government agencies, corporations, mortgage pass throughs and asset-backed securities.

Choice Of:

- **Cap Rate/Asset Fee Rate (AFR)**
  - **Cap Rate** - An upper limit applied to the Index credit. Cap rates are subject to change, declared each Contract anniversary, and guaranteed to never be less than 4% on the Annual Monthly Average and Annual Point to Point Crediting Methods. The Cap Rate on the Monthly Point to Point is guaranteed to never be less than 1%. (and)*

  - **Asset Fee Rate (AFR)** - A deduction used in calculation of Index Credit. AFR is set at issue, and guaranteed for life of contract.

-OR-

*No minimums in CA.

Monthly Point to Point*	Fixed Rate
Annual sum of monthly changes in the Index with cap less an asset fee	Fixed Interest Rate Declared
S&P 500®	Not Applicable
Annually	Daily
Cap & AFR	Not Applicable

*Provided by MPT Rider.

Participation Rate (PR) - The stated percentage of any Index increase credited to the contract. PRs are subject to change, declared annually, and guaranteed to never be less than 25%.*

INDEX CREDITING METHOD CHOICES

Annual Monthly Average - Index Credits are based on 12 dates during the year. The average is calculated by adding the 12 Index amounts on each monthly date and dividing by 12. Caps, Asset Fees, or Participation Rates are applied to the Index Credit Calculation.

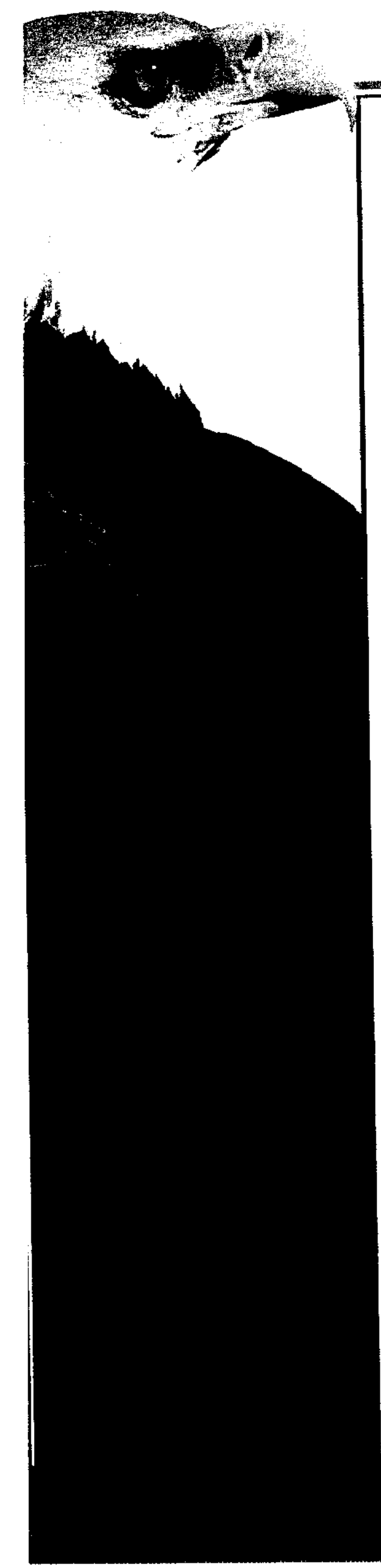
Annual Point to Point - On each Contract anniversary the Index value is compared to the previous years Index value. The Index Credit is based on the increase in the Index value from point to point. Caps, Asset Fees, or Participation Rates are applied to the Index Credit Calculation.

Monthly Point to Point - Each month a percentage of change is calculated. Caps are applied to any increase. The sum of the resulting monthly values, less an Asset Fee, is the Index Credit applied on each Contract Anniversary.

Fixed Value Rate based on a current declared interest rate guaranteed to never be less than the Fixed Value Minimum Guaranteed Interest Rate stated in the Contract.

Transfer of Values - American Equity annuities allow for annual transfers between different values allowing you greater flexibility in utilizing the interest crediting methods available. A Transfer of Values (TOV) letter and form are sent one month prior to the contract anniversary as a courtesy. Transfers can take place within five business days after the contract anniversary.

Bonus Gold Benefits and Accessibility



10% PREMIUM BONUS

We guarantee a 10% Premium Bonus for issue ages 0-80, 5% for issue ages 81-85. This Premium Bonus allows you to jump start your way to a secure retirement. Credited on all first year premiums, the bonus increases your Contract Value by 10% (or 5%) as soon as the contract is issued. There are no waiting periods, vesting schedules or payout requirements to keep the bonus –it's your money– guaranteed.

LIFETIME INCOME BENEFIT RIDER (LIBR-2008)

This rider allows the owner/annuitant to receive guaranteed income for life without annuitization. The income amount is a percentage of the Income Account Value (IAV) based on the owner/annuitant's age at time of election.

There are two IAV rate options to choose from. There may be a fee charged annually based on the IAV rate selected. We include this rider with all contracts where the Owner and Annuitant are the same person. If, on the day before Lifetime Income Benefit (LIB) payments begin, the IAV is less than the Contract Value we will increase the IAV to equal the Contract Value. See Lifetime Income Benefit Rider (LIBR) brochure (Form #1103) for more details.

DEATH BENEFIT

The Death Benefit is the full value of your contract and is paid in a lump sum with no surrender charges to your named beneficiaries. Other income options may also be available.

ACCESSIBILITY – 10% PENALTY-FREE WITHDRAWALS

We understand that access to your money is very important. While most financial vehicles charge penalties for withdrawals before maturity, our annuities offer annual 10% penalty-free withdrawals, beginning in year 2. In the first year, you may receive systematic withdrawals of interest or Required Minimum Distributions from the fixed interest account as quickly as 30 days after your contract is issued.*

NURSING CARE RIDER** – 20% PENALTY-FREE WITHDRAWALS

Our Nursing Care Rider is automatically included, at no cost, for Annuitants under age 75 at issue. This allows an increase in the penalty-free withdrawal amount up to 20% of the Contract Value for a qualified nursing care center confinement, beginning one year after issue and continuing for at least 90 consecutive days.

TERMINAL ILLNESS RIDER** – 75% PENALTY-FREE WITHDRAWAL

The Terminal Illness Rider is automatically included, at no cost, for Annuitants under age 75 at issue. After the contract is in force one year, this allows one penalty-free withdrawal of up to 75% of the Contract Value for a terminal illness expected to result in death within one year, as diagnosed by a qualified physician.

MINIMUM GUARANTEED SURRENDER VALUE (MGSV)

MGSV equals 80% (84% issue ages 81-85) of 1st year premiums and premium bonus, plus 87.5% of any additional premiums, less any Withdrawal Proceeds, at Minimum Guaranteed Interest Rate (MGIR) compounded annually.

CASH SURRENDER VALUE

Cash Surrender Value is equal to the greater of Contract Value minus any applicable Surrender Charges or MGSV.

SURRENDER CHARGES

Surrender charges are deducted for withdrawals exceeding the penalty-free amounts or full surrender, and apply for the first 16 years for issue ages 0-80, starting at 20% and decreasing. For issue ages 81-85, the surrender charges apply for the first 9 years, starting at 9% and decreasing. See disclosure for complete schedule.

*Not guaranteed and subject to change

**Not available in MA.
See Product Disclosure for further details.

Bonus Gold

INDEX-1-07*

INDEXED ANNUITY DISCLOSURE

ACCESSIBILITY
Our annuities offer Penalty-free Withdrawals up to **10%** of *your contract* value once annually after the first contract anniversary.

The Nursing Care Rider (NCR-2)* and Terminal Illness Rider (TIR-1)*, are for annuitants under age 75 at issue. These riders allow you to withdraw a larger portion of your money penalty free after the first contract year if you become confined to a nursing home or suffer a terminal illness.

TAX TREATMENT
You may be subject to a 10% Federal penalty if you make withdrawals or surrender this annuity before age 59½. If this annuity is within a qualified plan all distributions may be taxable. Under current tax laws annuities grow tax deferred and an annuity is not required for tax deferral in a qualified plan. Any distribution may cause a taxable event. Neither American Equity nor our agents offer legal, investment, or tax advice. Please consult a qualified advisor for these matters.

The S&P 500® and DJIA℠ Indices do not include dividends.

"Standard & Poor's®", "S&P®", "S&P 500®", "Standard & Poor's 500", and "500" are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by American Equity Investment Life Insurance Company. This product is not sponsored, endorsed, sold or promoted by Standard & Poor's, and Standard & Poor's makes no representation regarding the advisability of purchasing this product.

Dow Jones", "Dow Jones Industrial Average℠" and "DJIA℠" are service marks of Dow Jones & Company, Inc. and have been licensed for use for certain purposes by American Equity Investment Life Insurance Company. This product, based on the DJIA℠, is not sponsored, endorsed, sold or promoted by Dow Jones and Dow Jones makes no representation regarding the advisability of purchasing this product.

This product is not sponsored, endorsed, sold or promoted by Lehman Brothers and Lehman Brothers makes no representation regarding the advisability of purchasing this product.

1107-D 05/01/08

American Equity's Bonus Gold provides an alternative for your financial future. The design of this product allows for long-term accumulation of money you don't anticipate needing in the short term. Bonus Gold is a flexible premium fixed indexed deferred annuity. Bonus Gold offers:

10% PREMIUM BONUS+
Credited on all 1st year Premiums, the bonus increases your Contract Value by 10% as soon as the Contract is issued. We don't require annuitization to keep credited bonus in your Contract Value. The bonus is included in the calculation of:

- Death Benefit
- Minimum Guaranteed Surrender Value
- Cash Surrender Value
- Income Account Value

+Issue ages 0-80, 5% bonus for issue ages 81-85.

VALUE CALCULATIONS
Indexed Values are calculated by:

- Adding any premiums paid plus any credited bonus
- Subtracting any withdrawals, including associated surrender charges and
- Adding Index credits to determine an indexed value.

The total Indexed Value is the sum of the Indexed Value calculations for the Bond, Averaged, Point to Point, and Monthly Point to Point Values.

Fixed Value is calculated in the same way except interest credited is based on a fixed interest rate rather than an Index Credit.

The Contract Value equals the sum of the Fixed and Indexed Values. The Contract Value is calculated on each contract anniversary.

MINIMUM GUARANTEES
We set the Minimum Guaranteed Interest Rate on the issue date and guarantee it for the life of the contract. It is guaranteed to never be less than 1%, and applies to Minimum Guaranteed Surrender Value only. The Fixed Value Minimum Guaranteed Interest Rate is 1%.

LIFETIME INCOME BENEFIT RIDER (LIBR-2008)
This rider allows you to take a guaranteed lifetime income from your annuity without losing control of your retirement assets. The rider:

- Provides a lifetime income that you cannot outlive
- Does not require annuitization to receive Lifetime Income Benefit payments
- Calculates lifetime income as a percentage of the Income Account Value (IAV) based on the Owner/Annuitant's age at time of election. The IAV is determined by taking total premiums paid, plus any premium bonus accumulated at selected IAV rate annually until the earliest of the 10th Contract Anniversary, the date LIB payments begin, or either the Rider or base contract terminates.
- May have a Rider Fee depending on which IAV rate is selected. We may reset the Rider Fees if you choose to restart your IAV period.
- Allows you to restart the IAV accumulation period once between the 5th and 10th Contract Anniversary
- Is automatically added only if the Owner and Annuitant are the same person

Before we can issue your annuity contract, you must choose your IAV Rate by completing the Lifetime Income Benefit Rider Authorization, form #1103-D.

* Form numbers vary by state. (NCR-2) and (TIR-1) not available in MA.

Owner's Initials

Bonus Gold INDEX-1-07*

SURRENDER CHARGES

Surrender Charges are deducted from your Contract Values in the event of:
1. Full Surrender or
2. Withdrawals in the first year or
3. Withdrawals in excess of the Penalty-free Withdrawal amount during the surrender charge period shown below:

Issue Ages 0-80

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17+
%	20	19.5	19	18.5	18	17.5	17	16	15	14	12	10	8	6	4	2	0

Issue Ages 81-85

Year	1	2	3	4	5	6	7	8	9	10+
%	9	8	7	6	5	4	3	2	1	0

Surrender Charges may vary by state.

The Minimum Guaranteed Surrender Value equals 80% (or 84% for issue ages 81-85) of premiums paid in the first year including the Premium Bonus, plus 87.5% of any additional premiums paid after the 1st year, minus any withdrawals, all accumulated at the Minimum Guaranteed Interest Rate.

The Cash Surrender Value equals the greater of the Contract Value minus any Surrender Charges or the Minimum Guaranteed Surrender Value. Your Cash Surrender Value can never be lower than the Minimum Guaranteed Surrender Value of the Contract.

CHOICES AND FLEXIBILITY

You choose how to allocate your total initial premium. You may make additional premium payments in any amount and frequency within the premium limits. Additional premiums are automatically credited to the Fixed Value. The contract offers additional flexibility by allowing you to transfer money in or out of any value on each contract anniversary. Additional premiums credited to the Fixed Value can be transferred to other values at that time.

- The minimum initial premium is $5,000.
- The minimum allocation for each value is $1,000.
- The minimum transfer to select a new value is 10% of the Contract Value.

Nine interest crediting methods offer a variety of choices. For a detailed description of each crediting method refer to page 4 of brochure.

1 Traditional Fixed Value Interest Rate
2 S&P 500 Annual Monthly Average w/Cap & AFR
3 S&P 500 Annual Monthly Average w/PR**
4 S&P 500 Annual Pt. to Pt. w/ Cap & AFR
5 S&P 500 Annual Pt. to Pt. w/PR**
6 S&P Monthly Pt. to Pt. w/ Cap & AFR**
7 Dow Annual Monthly Average w/Cap & AFR
8 Dow Annual Pt. to Pt. w/Cap & AFR
9 Lehman Brothers U.S. Aggregate Annual Pt. to Pt. w/ Cap and AFR

TOTAL INITIAL PREMIUM ALLOCATION:

1 ________%
2 ________%
3 ________%
4 ________%
5 ________%
6 ________%
7 ________%
8 ________%
9 ________%
100%

You will have the benefit of an annual reset of index credits. Your index credits become part of the Contract Value once credited and can never be lost or taken away.

**Provided by the MA-PR, APT-PR & MPT riders. Available in most states.

DEATH BENEFIT

The Death Benefit offers a variety of settlement options. Your beneficiary(ies) will have access to your contract's full value. Settlement options include a lump sum payout, the guaranteed income of annuitization, penalty-free and continued tax deferral if you are a spouse. The Death Benefit is the greater of the Contract Value or Minimum Guaranteed Surrender Value at the death of the Annuitant or Owner, whichever comes first.

1107-D 05/01/08

This disclosure is intended to summarize this Annuity. Consult your Contract for specific terms and conditions of your Annuity. Annuity contracts are products of the insurance industry and are not guaranteed by any bank or insured by the FDIC. 100% of your premium is applied to this contract. Your agent is paid a commission from American Equity.

If you are replacing an existing contract, carefully compare the benefits of the proposed contract with your existing contract to ensure your decision is in your best interest.

I have read and received a copy of this document and a copy of the NAIC Buyer's Guide to Indexed Annuities.*** I understand I am applying for an indexed annuity and that past Interest and Index activity is not intended to predict future activity. I also acknowledge that this annuity meets my financial objectives and that a full surrender or withdrawals over penalty free amount taken within the Surrender Charge Period will result in Surrender Charges being assessed and potential loss of Premium.

____
Owner's Signature **Date**

____
Joint Owner's Signature **Date**

Agents Statement - I certify that I have provided a copy of this document*** to the applicant and I have made no promises or assurances regarding values of the contract, nor have I made statements that differ from this disclosure.

____
Agent's Signature **Date**

____
Agent's State License Number

***NAIC Buyer's Guide is recommended for all applications and **delivery is required** at the time of the application in AZ, CO, HI, and UT.

AMOUNT OF PREMIUM RECEIVED

$______________________________
Amount Received From

____
Owner's Name

____
Date

____
Agent's Name - Please Print

____
Agent's Signature

American Equity Investment Life Insurance Company
P.O. Box 71216
Des Moines, Iowa 50325
www.american-equity.com
888-221-1234

IMSA INSURANCE MARKETPLACE STANDARDS ASSOCIATION

AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY

SEE YOUR CONTRACT FOR CURRENT INTEREST, CAPS, PARTICIPATION AND ASSET FEE RATES. Not complete without both pages.

Bonus Gold

INDEX-1-07*

INDEXED ANNUITY DISCLOSURE

American Equity's Bonus Gold provides an alternative for your financial future. The design of this product allows for long-term accumulation of money you don't anticipate needing in the short term. Bonus Gold is a flexible premium fixed indexed deferred annuity. Bonus Gold offers:

10% PREMIUM BONUS+

Credited on all 1st year Premiums, the bonus increases your Contract Value by 10% as soon as the Contract is issued. We don't require annuitization to keep credited bonus in your Contract Value. The bonus is included in the calculation of:

- Death Benefit
- Minimum Guaranteed Surrender Value
- Cash Surrender Value
- Income Account Value

+Issue ages 0-80, 5% bonus for issue ages 81-85.

VALUE CALCULATIONS

Indexed Values are calculated by:

- Adding any premiums paid plus any credited bonus
- Subtracting any withdrawals, including associated surrender charges and
- Adding Index credits to determine an indexed value.

The total Indexed Value is the sum of the Indexed Value calculations for the Bond, Averaged, Point to Point, and Monthly Point to Point Values.

Fixed Value is calculated in the same way except interest credited is based on a fixed interest rate rather than an Index Credit.

The Contract Value equals the sum of the Fixed and Indexed Values. The Contract Value is calculated on each contract anniversary.

MINIMUM GUARANTEES

We set the Minimum Guaranteed Interest Rate on the issue date and guarantee it for the life of the contract. It is guaranteed to never be less than 1%, and applies to Minimum Guaranteed Surrender Value only. The Fixed Value Minimum Guaranteed Interest Rate is 1%.

LIFETIME INCOME BENEFIT RIDER (LIBR-2008)

This rider allows you to take a guaranteed lifetime income from your annuity without losing control of your retirement assets. The rider:

- Provides a lifetime income that you cannot outlive
- Does not require annuitization to receive Lifetime Income Benefit payments
- Calculates lifetime income as a percentage of the Income Account Value (IAV) based on the Owner/Annuitant's age at time of election. The IAV is determined by taking total premiums paid, plus any premium bonus accumulated at selected IAV rate annually until the earliest of the 10th Contract Anniversary, the date LIB payments begin, or either the Rider or base contract terminates.
- May have a Rider Fee depending on which IAV rate is selected. We may reset the Rider Fees if you choose to restart your IAV period.
- Allows you to restart the IAV accumulation period once between the 5th and 10th Contract Anniversary
- Is automatically added only if the Owner and Annuitant are the same person

Before we can issue your annuity contract, you must choose your IAV Rate by completing the Lifetime Income Benefit Rider Authorization, form #1103-D.

ACCESSIBILITY

Our annuities offer Penalty-free Withdrawals up to **10%** of your contract value once annually after the first contract anniversary.

The Nursing Care Rider (NCR-2)* and Terminal Illness Rider (TIR-1)*, are for annuitants under age 75 at issue. These riders allow you to withdraw a larger portion of your money penalty free after the first contract year if you become confined to a nursing home or suffer a terminal illness.

TAX TREATMENT

You may be subject to a 10% Federal penalty if you make withdrawals or surrender this annuity before age 59½. If this annuity is within a qualified plan all distributions may be taxable. Under current tax laws annuities grow tax deferred and an annuity is not required for tax deferral in a qualified plan. Any distribution may cause a taxable event. Neither American Equity nor our agents offer legal, investment, or tax advice. Please consult a qualified advisor for these matters.

The S&P 500® and DJIA℠ Indices do not include dividends.

1107-D 05/01/08

* Form numbers vary by state. (NCR-2) and (TIR-1) not available in MA.

Owner's Initials

Bonus Gold INDEX-1-07*

SURRENDER CHARGES

Surrender Charges are deducted from your Contract Values in the event of:
1. Full Surrender or
2. Withdrawals in the first year or
3. Withdrawals in excess of the Penalty-free Withdrawal amount during the surrender charge period shown below:

Issue Ages 0-80

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17+
%	20	19.5	19	18.5	18	17.5	17	16	15	14	12	10	8	6	4	2	0

Issue Ages 81-85

Year	1	2	3	4	5	6	7	8	9	10+
%	9	8	7	6	5	4	3	2	1	0

Surrender Charges may vary by state.

The Minimum Guaranteed Surrender Value equals 80% (or 84% for issue ages 81-85) of premiums paid in the first year including the Premium Bonus, plus 87.5% of any additional premiums paid after the 1st year, minus any withdrawals, all accumulated at the Minimum Guaranteed Interest Rate.

The Cash Surrender Value equals the greater of the Contract Value minus any Surrender Charges or the Minimum Guaranteed Surrender Value. Your Cash Surrender Value can never be lower than the Minimum Guaranteed Surrender Value of the Contract.

CHOICES AND FLEXIBILITY

You choose how to allocate your total initial premium. You may make additional premium payments in any amount and frequency within the premium limits. Additional premiums are automatically credited to the Fixed Value. The contract offers additional flexibility by allowing you to transfer money in or out of any value on each contract anniversary. Additional premiums credited to the Fixed Value can be transferred to other values at that time.

- The minimum initial premium is $5,000.
- The minimum allocation for each value is $1,000.
- The minimum transfer to select a new value is 10% of the Contract Value.

Nine interest crediting methods offer a variety of choices. For a detailed description of each crediting method refer to page 4 of brochure.

1 Traditional Fixed Value Interest Rate
2 S&P 500 Annual Monthly Average w/Cap & AFR
3 S&P 500 Annual Monthly Average w/PR**
4 S&P 500 Annual Pt. to Pt. w/ Cap & AFR
5 S&P 500 Annual Pt. to Pt. w/PR**
6 S&P Monthly Pt. to Pt. w/ Cap & AFR**
7 Dow Annual Monthly Average w/Cap & AFR
8 Dow Annual Pt. to Pt. w/Cap & AFR
9 Lehman Brothers U.S. Aggregate Annual Pt. to Pt. w/ Cap and AFR

TOTAL INITIAL PREMIUM ALLOCATION:

1 ____%
2 ____%
3 ____%
4 ____%
5 ____%
6 ____%
7 ____%
8 ____%
9 ____%
100%

You will have the benefit of an annual reset of index credits. Your index credits become part of the Contract Value once credited and can never be lost or taken away.

**Provided by the MA-PR, APT-PR & MPT riders. Available in most states.

DEATH BENEFIT

The Death Benefit offers a variety of settlement options. Your beneficiary(ies) will have access to your contract's full value. Settlement options include a lump sum payout, the guaranteed income of annuitization, penalty-free and continued tax deferral if you are a spouse. The Death Benefit is the greater of the Contract Value or Minimum Guaranteed Surrender Value at the death of the Annuitant or Owner, whichever comes first.

1107-D 05/01/08

This disclosure is intended to summarize this Annuity. Consult your Contract for specific terms and conditions of your Annuity. Annuity contracts are products of the insurance industry and are not guaranteed by any bank or insured by the FDIC. 100% of your premium is applied to this contract. Your agent is paid a commission from American Equity.

If you are replacing an existing contract, carefully compare the benefits of the proposed contract with your existing contract to ensure your decision is in your best interest.

I have read and received a copy of this document and a copy of the NAIC Buyer's Guide to Indexed Annuities.*** I understand I am applying for an indexed annuity and that past Interest and Index activity is not intended to predict future activity. I also acknowledge that this annuity meets my financial objectives and that a full surrender or withdrawals over penalty free amount taken within the Surrender Charge Period will result in Surrender Charges being assessed and potential loss of Premium.

____
Owner's Signature **Date**

____
Joint Owner's Signature **Date**

Agents Statement - I certify that I have provided a copy of this document*** to the applicant and I have made no promises or assurances regarding values of the contract, nor have I made statements that differ from this disclosure.

____
Agent's Signature **Date**

____
Agent's State License Number

***NAIC Buyer's Guide is recommended for all applications and **delivery is required** at the time of the application in AZ, CO, HI, and UT.

AMOUNT OF PREMIUM RECEIVED

$ ______________________________
Amount Received From

____
Owner's Name

____
Date

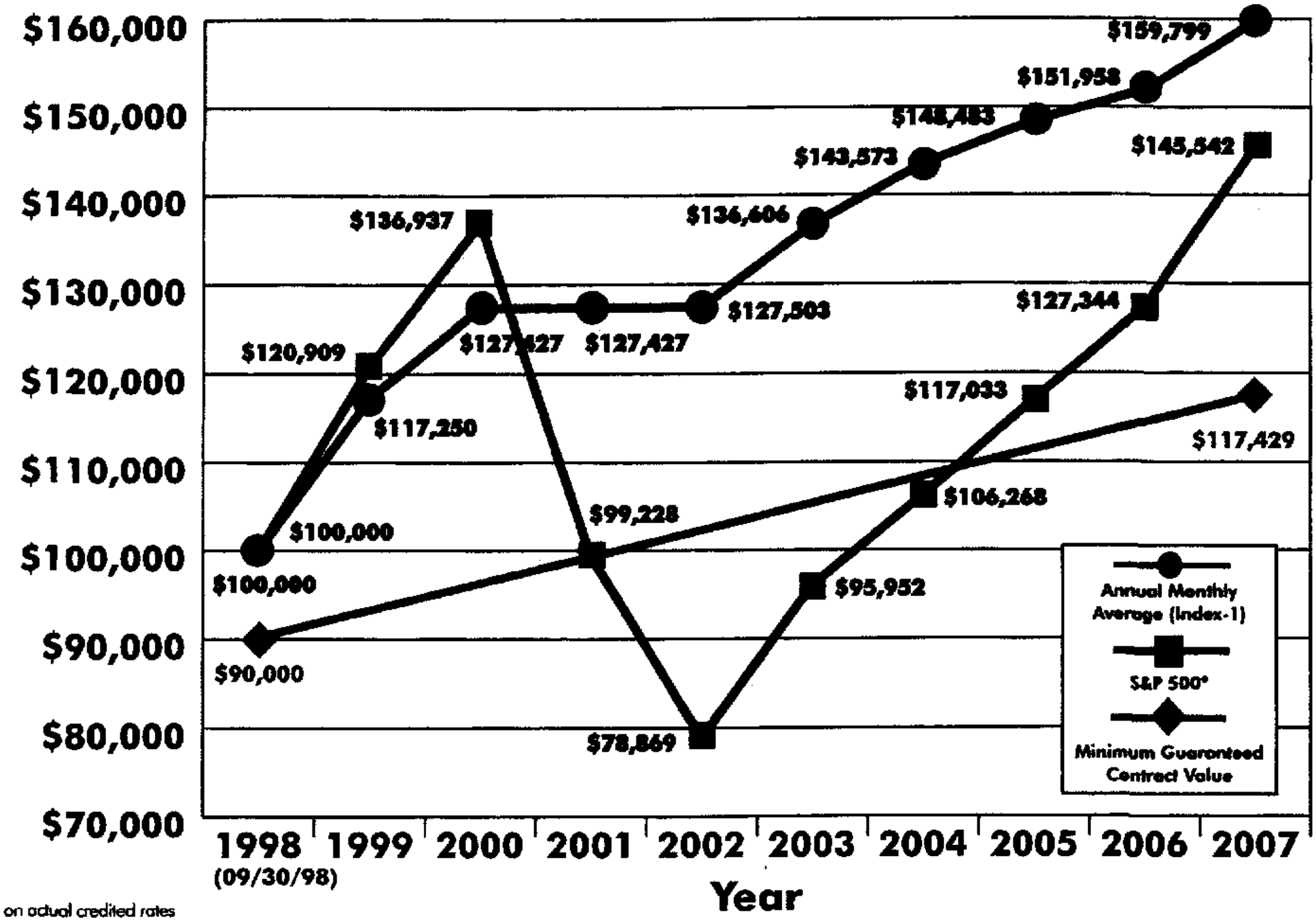
____
Agent's Name - Please Print

____
Agent's Signature

American Equity Investment Life Insurance Company
P.O. Box 71216
Des Moines, Iowa 50325
www.american-equity.com
888-221-1234

INSURANCE MARKETPLACE STANDARDS ASSOCIATION

Real Benefits of Indexed Annuities



*This graph is based on actual credited rates for the period shown on the Index I product, which is no longer available for sale.

Past performance not an indication of future results. Please call our Marketing Department for new product information.

"Standard & Poors®", "S&P®", "S&P 500®", "Standard & Poor's 500", and "500" are trademarks of the McGraw-Hill Companies, Inc. and have been licensed for use by American Equity Investment Life Insurance Company. This product is not sponsored, endorsed, sold or promoted by Standard & Poor's, and Standard & Poor's makes no representation regarding the advisability of purchasing this product. S&P 500® index does not contain dividends.

Participation Rates apply, may change annually on Contract Anniversary.

Neither American Equity Investment Life Insurance Company nor any of our agents give legal, tax or investment advice. Consult your own personal advisor regarding these matters.

Indexed Annuities are products of the insurance industry and are not guaranteed by any bank, or insured by the FDIC.

A HISTORY OF AMERICAN EQUITY'S INDEX-1* (9/30/98 - 9/30/07)

This history of American Equity's Index-I Indexed Annuity demonstrates the powerful benefits of Indexed Annuities with the annual reset interest crediting design. *All of our current* products offer annual reset design as well. The Index-I did exactly what it was supposed to do... give the Contract Owner the opportunity to accumulate value based on the appreciation of the S&P 500® Index, without the risk of loss of Premium in years when the S&P 500® was negative. All of this supported by a Minimum Guarantee.

NOW THAT'S HAVING YOUR CAKE AND EATING IT TOO!

These results should not be an indication that Indexed Annuities will beat the S&P 500® every time. This simply demonstrates the effectiveness of Indexed Annuities *in years* when the S&P 500® was negative.

Surrender Charges apply to surrenders or withdrawals taken in excess of the free withdrawal provision during the Surrender Charge Period.

Safety Index® 10

Old Mutual® is the marketing name of OM Financial Life Insurance Company, and in NY only, OM Financial Life Insurance Company of New York, Old Mutual plc companies.

Each Old Mutual company is solely responsible for its contractual commitments.

Fixed Indexed Annuity Protection and Growth Potential for Your Savings

OLD MUTUAL®
INVEST INSURE INNOVATE

OM Financial Life Insurance Company
ADLF 8566 (07-2006)

06-253 Rev.02-2008

Thank you for your interest in the SAFETY INDEX 10 annuity from OM Financial Life Insurance Company. SAFETY INDEX 10 has an adaptable combination of interest options for your retirement dollars, and offers terrific guarantees, such as a minimum guaranteed surrender value that is 100% of your premiums compounding at 3% (less a surrender charge). On the fixed option, the initial interest rate is GUARANTEED for seven years, and is guaranteed to be equal to or greater than 3% for the life of the policy! Additionally, you have the security of the annual reset feature, where any account gains are locked in at the end of each year – your account will never decrease in value! You also have riders to address unexpected contingencies such as unemployment, diagnosis of a terminal illness or nursing home confinement. OM Financial Life has prepared this summary to help you understand SAFETY INDEX 10's many options and advantages. Please confirm your understanding by signing the enclosed confirmation statement.

A Fixed Indexed Annuity

Safety Index 10 is a flexible premium deferred interest indexed annuity with four indexed interest options and one fixed interest rate option. Safety Index 10 is designed to be a long-term retirement savings tool with many features to help you reach the standard of living you want during your retirement.

Tax Advantages

Although an annuity does not eliminate your tax liability on interest earnings, under current tax law all interest income earned accumulates on a tax-deferred basis. This tax deferral is currently available only to individual and joint owners, not to corporations or other non-individuals, under most circumstances. When purchased to fund a tax-qualified plan, there is no additional tax-deferral beyond that already provided by the plan; however, there may be other benefits worth considering.

A Choice of 5 Interest-Crediting Options

Safety Index 10 offers a choice of five interest crediting options. These options are 1-year monthly point-to-point with a cap, 1-year annual point-to-point with a cap, 1-year monthly average with a cap, 1-year monthly average with a spread and a fixed interest option. On the application, you can allocate your premiums among these five options. You may reallocate your account value between these options on each annuity anniversary. Interest rates are subject to change except as guaranteed.

Index Interest Options

If you choose to allocate some or all of your premiums to the index interest options, your interest credits will be credited annually based on formulas linked to changes in the monthly averaged or point-to-point values in the index, with each option subject to either a cap rate or spread rate. The cap rate is the maximum percentage applied on each anniversary as part of the total calculation for the annual index interest credit. The cap rate is declared in advance. The spread rate is a percentage declared in advance which is deducted as part of the calculation of the annual index interest credit. The monthly point-to-point index changes are subject to a cap that will never be less than one percent per month.
The annual point-to-point and annual monthly average index changes are subject to caps that will never be less than three percent per year. The annual monthly average index spread rate will never be greater than nine percent per year. These index interest options may result in no interest credits, but the credit will never be less than zero.

Index interest credits are not calculated or credited between index interest crediting dates; consequently, amounts surrendered between index interest crediting dates will not earn any interest credits. Any interest credit is applied to your annuity on its annual anniversary and is locked-in, so future decreases in any index will not affect the interest already credited to your annuity.

Fixed Interest Crediting

If you choose to allocate some or all of your premium to the fixed-interest option, interest is credited daily. The issued annuity will show the credited interest rate applicable for the first seven years. After the initial guarantee period, we will declare a new current rate annually and will never credit less than 3%.

Minimum Guaranteed Surrender Value (MGSV)

Your Safety Index 10 annuity contains a protective floor that increases with interest on your cash surrender value for the index interest options. The minimum guaranteed surrender value on a full surrender is 100% of premium, plus daily interest accruing at 3% less any current surrender charges. MGSV is reduced by prior withdrawals and adjusted for any reallocations.

Payment in the Event of Death or Annuity Payout Options

Should you die before electing to receive income payments, the account value will be paid to the beneficiary named in your annuity. If you choose to receive annuity payments, and the annuity date is after the fifth certificate anniversary, we will apply the greater of the account value or the minimum guaranteed surrender value to the annuity option then in effect. If the annuity date is before the fifth certificate anniversary, we will apply the greater of the surrender value or the minimum guaranteed surrender value to the annuity option then in effect.

Account Value

The annuity's account value before the annuity date consists of the fixed interest option's account value plus the indexed interest options account value.

Surrender Value

For a full surrender, the surrender value is the greater of:

- Total account value, less surrender charges; or
- Total minimum guaranteed surrender value

No Initial Sales Charges or Fees

There are no initial sales charges or fees. Your full initial premium is available to earn interest from the date your annuity is issued. Annuities are issued with an issue date of the 1st, 8th, 15th and 22nd of each month. Premium checks will be held without interest, until the next available issue date. In order to be issued with the next available issue date, applications must be received no later than 5:00 p.m. (Eastern time) two business days prior to that issue date.

For special rules about issue dates that fall on holidays or weekends, contact OM Financial Life. The minimum initial premium is $15,000 and the minimum allocation to any option is $2,000.

How Index-Linked Interest Crediting Works

One-Year Monthly Point-to-Point with a Cap

The monthly point-to-point index change is determined by subtracting the prior month's index value from current month's index value and dividing it by the prior month's index value. If this results in a positive monthly point-to-point index change and is not more than the declared cap, then it is used as the index change for that month. If it is more than the declared cap, then we use the declared cap as the index change for that month. Negative monthly point-to-point index changes are also applicable.

An index change for each month is captured over a 12-month period. The sum of the 12 monthly index changes will be the index credit rate on the index crediting date. The index credit rate is multiplied by the option's account value to determine the index interest credit.

One-Year Annual Point-to-Point with a Cap

The annual point-to-point index change is determined by subtracting the prior year's index value from the current year's index value and dividing it by the prior year's index value. If this results in a positive annual point-to-point index change and is not more than the declared cap, then it is used as the index change for that year. If it is more than the declared cap, then we use the declared cap as the index change for that year.

A negative annual point-to-point index change is not subject to a cap. The index change will be the index credit rate on the index crediting date. The index credit rate is multiplied by the option's account value to determine the index interest credit.

One-Year Monthly Average w/ a Cap

The index values are measured at one-month intervals from the month after the prior anniversary to the month of the anniversary inclusive. The index average is the average of the index values of the twelve months during each year. The index change (which is calculated on the anniversary) is the index average minus the index value on the prior anniversary; divided by the index value on the prior anniversary. If the index change results in a positive index change and is not more than the declared cap, then it is used as the index change for that year. If it is more than the declared cap, then we use the declared cap as the index change for that year. This "averaging" formula helps smooth out the index values used to calculate your index-linked interest rate, which helps protect your interest rate gains from severe declines in the index during the interest crediting period. This averaging method may also reduce the amount of interest that could be earned if the index rises steadily throughout the year or increases sharply at the end of the year.

One-Year Monthly Average with a Spread

The index values are measured at one-month intervals from the month after the prior anniversary to the month of the anniversary inclusive. The index average is the average of the index values of the twelve months during each year. The index change (which is calculated on the anniversary) is the index average minus the index value on the prior anniversary; divided by the index value on the prior anniversary. A spread rate, declared annually, is deducted from the index change to determine the final index credit. This "averaging" formula helps smooth out the index values used to calculate your index-linked interest rate, which helps protect your interest rate gains from severe declines in the index during the interest crediting period. If the spread rate reaches 9%, the option would be suspended, and any funds in this option will be allocated uniformly across the remaining index interest options.

You are purchasing a fixed index annuity that provides minimum guaranteed surrender values. You should understand how your minimum guaranteed surrender values are determined and the features of the product that are used to determine the values. Even though the values of the annuity may be affected by external indices, this product is not an investment in the stock market and does not participate in any stock, bond or indexed investments.

Hypothetical Examples

The following examples are not intended to be representations of past or future performance of Safety Index 4. These examples use hypothetical caps and index value changes.

Steadily increasing index

Assume the index rises steadily. Safety Index 4's index-linked formula results in the following interest credit for monthly point-to-point, monthly average, and annual point-to-point index options.

MONTHLY POINT-TO-POINT

Month	Index	Monthly Increase	Capped Increase *monthly cap rate = 3.00%*
1	900.00		
2	909.30	1.03%	[illegible]
3	911.20	0.21%	0.21%
[illegible]	913.30	0.23%	[illegible]
5	914.40	0.12%	0.12%
[illegible]	921.30	0.75%	[illegible]
7	922.80	0.16%	0.16%
[illegible]	926.20	0.37%	[illegible]
9	928.10	0.21%	0.21%
[illegible]	936.70	0.93%	[illegible]
11	947.30	1.13%	1.13%
[illegible]	952.90	0.59%	[illegible]
13	972.10	2.01%	2.01%
Total of monthly capped increases			7.74%
Annual Interest Credit - Monthly Pt-to-Pt w/ a Cap			**7.74%**

ANNUAL PT-TO-PT

Date	Index	Increase	Capped Increase *annual cap rate = 9%*
Initial	900.00		
[illegible]	972.10	8.01%	[illegible]
Annual Interest Credit - Annual Pt-to-Pt w/ a Cap			**8.01%**

MONTHLY AVG W/ CAP

Date	Index	Increase	Capped Increase *annual cap rate = 10%*
Initial	900.00		
[illegible]	929.63	3.29%	[illegible]
Annual Interest Credit - Monthly Average w/ Cap			**3.29%**

MONTHLY AVG W/ SPREAD

Date	Index	Increase	Increase After Spread *annual spread rate = 1.5%*
Initial	900.00		
[illegible]	929.63	3.29%	[illegible]
Annual Interest Credit - Monthly Average w/ Spread			**1.79%**

Sharply increasing index

Assume the index rises sharply. Safety Index 7's index-linked formula results in the following interest credit for monthly point-to-point, monthly average, and annual point-to-point index options.

MONTHLY POINT-TO-POINT

Month	Index	Monthly Increase	Capped Increase *monthly cap rate = 3.00%*
1	900.00		
2	925.65	2.85%	[illegible]
3	923.61	-0.22%	-0.22%
[illegible]	939.13	1.68%	[illegible]
5	1004.96	7.01%	3.00%
[illegible]	1008.28	0.33%	[illegible]
7	1014.43	0.61%	0.61%
[illegible]	1032.99	1.83%	[illegible]
9	1041.15	0.79%	0.79%
[illegible]	1040.22	-0.09%	[illegible]
11	1116.78	7.36%	3.00%
12	1123.37	0.59%	[illegible]
13	1126.51	0.28%	0.28%
Total of monthly capped increases			14.65%
Annual Interest Credit - Monthly Pt-to-Pt w/ a Cap			**14.65%**

ANNUAL PT-TO-PT

Date	Index	Increase	Capped Increase *annual cap rate = 9%*
Initial	900.00		
[illegible]	1126.51	25.17%	[illegible]
Annual Interest Credit - Annual Pt-to-Pt w/ a Cap			**9.00%**

MONTHLY AVG W/ CAP

Date	Index	Increase	Capped Increase *annual cap rate = 10%*
Initial	900.00		
[illegible]	1024.76	13.86%	[illegible]
Annual Interest Credit - Monthly Average w/ Cap			**10.00%**

MONTHLY AVG W/ SPREAD

Date	Index	Increase	Increase After Spread *annual spread rate = 1.5%*
Initial	900.00		
[illegible]	1024.76	13.86%	[illegible]
Annual Interest Credit - Monthly Average w/ Spread			**12.36%**

Upside Potential

Principal Protection

Minimum Interest Guaranteed on Surrender Value

Steadily increasing and a sharp drop in the index

Assume the index rises steadily, sharply drops and then sharply increases. Safety Index 4's index-linked formula results in the following interest credit for monthly point-to-point, monthly average, and annual point-to-point index options.

MONTHLY POINT-TO-POINT

Month	Index	Monthly Increase	Capped Increase *monthly cap rate = 3.00%*
1	900.00		
2	983.25	9.25%	[illegible]
3	1020.91	3.83%	3.00%
[illegible]	1033.98	1.28%	[illegible]
5	1118.87	8.21%	3.00%
[illegible]	967.37	-13.54%	[illegible]
7	1026.48	6.11%	3.00%
[illegible]	983.16	-4.22%	[illegible]
9	995.84	1.29%	1.29%
[illegible]	1014.86	1.91%	[illegible]
11	1077.38	6.16%	3.00%
[illegible]	1094.51	1.58%	[illegible]
13	1123.73	2.67%	2.67%
Total of monthly capped increases			5.98%
Annual Interest Credit - Monthly Pt-to-Pt w/ a Cap			**5.98%**

ANNUAL PT-TO-PT

Date	Index	Increase	Capped Increase *annual cap rate = 9%*
Initial	900.00		
[illegible]	1123.73	24.86%	[illegible]
Annual Interest Credit - Annual Pt-to-Pt w/ a Cap			**9.00%**

MONTHLY AVG W/ CAP

Date	Index	Increase	Capped Increase *annual cap rate = 10%*
Initial	900.00		
[illegible]	1036.70	15.19%	[illegible]
Annual Interest Credit - Monthly Average w/ Cap			**10.00%**

MONTHLY AVG W/ SPREAD

Date	Index	Increase	Increase After Spread *annual spread rate = 1.5%*
Initial	900.00		
[illegible]	1036.70	15.19%	[illegible]
Annual Interest Credit - Monthly Average w/ Spread			**13.69%**

Decreasing index

Assume the index decreases throughout the year and ends with a decrease. Safety Index 4's index-linked formula would result in a 0.00% credit instead of a negative credit for each of your four interest-crediting options.

MONTHLY POINT-TO-POINT

Month	Index	Monthly Increase	Capped Increase *monthly cap rate = 3.00%*
1	900.00		
2	803.25	-10.75%	[illegible]
3	834.01	3.83%	3.00%
[illegible]	844.69	1.28%	[illegible]
5	914.04	8.21%	3.00%
[illegible]	790.28	-13.54%	[illegible]
7	838.56	6.11%	3.00%
[illegible]	803.18	-4.22%	[illegible]
9	813.54	1.29%	1.29%
10	769.20	-5.45%	[illegible]
11	780.43	1.46%	1.46%
12	788.62	1.05%	[illegible]
13	809.68	2.67%	2.67%
Total of monthly capped increases			-17.21%
Annual Interest Credit - Monthly Pt-to-Pt w/ a Cap			**0.0%**

ANNUAL PT-TO-PT

Date	Index	Increase	Capped Increase *annual cap rate = 9%*
Initial	900.00		
[illegible]	809.88	-10.04%	[illegible]
Annual Interest Credit - Annual Pt-to-Pt w/ a Cap			**0.00%**

MONTHLY AVG W/ CAP

Date	Index	Increase	Capped Increase *annual cap rate = 10%*
Initial	900.00		
[illegible]	815.79	-9.36%	[illegible]
Annual Interest Credit - Monthly Average w/ Cap			**10.00%**

MONTHLY AVERAGE

Date	Index	Increase	Increase After Spread *annual spread rate = 1.5%*
Initial	900.00		
[illegible]	815.79	-9.36%	[illegible]
Annual Interest Credit - Monthly Average w/ Spread			**0.00%**

With the annual reset feature, all gains from previous years are locked in – your account will never decrease as long as no withdrawals are made!

When Surrender Charges Apply

The surrender charge applies for the first 10 years on full or partial surrenders (withdrawals), and in calculating the annuity payments unless it does not apply under the conditions below.

Surrender Charges

Annuity Year	Surrender Charge Percentage
1	10%
2	10%
3	10%
4	9%
5	8%
6	7%
7	6%
8	5%
9	4%
10	3%
11	0%

The surrender charge equals the surrender charge percentage for the applicable year multiplied by the amount of account value withdrawn. Please review your annuity for the appropriate surrender charge schedule.

When Surrender Charges Do Not Apply

Surrender charges are not deducted from the account value when you request a surrender if any of the following benefits or situations, which may be provided by rider, are issued as part of or apply to your annuity:

1. You surrender 10% or less of the account value as of the prior policy anniversary, less any amounts previously surrendered in the current policy year which were not subject to surrender charges.
2. You exercise an annuity option after the 5th anniversary or later.
3. You are confined to a licensed nursing home for more than 60 days and the confinement begins after the first annuity year (the surrender must be made during the period of confinement).
4. A licensed physician certifies that you have been diagnosed with an illness or condition that causes your life expectancy to be less than one year (the diagnosis must be at least one year after the annuity's date of issue).
5. Your unemployment began after the date of issue, has continued for at least 30 consecutive days, and you are under the age of 65 at the time of your request (the surrender must be made during the period of unemployment).
6. When the death benefit is paid, unless the spouse of the first owner to die continues ownership of the annuity and subsequently surrenders the annuity.

Note that if you fully surrender the annuity or exercise one of the options because of the circumstances described above, the surrender value will equal the greater of the account value or the minimum guaranteed surrender value.

Taxation of Withdrawals

Withdrawals may be subject to income tax. If withdrawals are made before age 59½, they also may be subject to an IRS penalty tax. Please consult your tax advisor regarding your unique situation.

Minimum Required Distributions

Certain tax qualified annuities are subject to minimum required distributions which generally require that distributions begin no later than your attainment of age 70½ and that amounts be paid to you over a period not longer than your life expectancy.

Right to Examine Annuity

This annuity includes a right of examination period. This means that within the specified time period after you receive your annuity, you may return the annuity and receive a refund of 100% of the premium paid, minus any prior withdrawals.

Financial Security

Your annuity values are guaranteed solely by OM Financial Life Insurance Company. As a Legal reserve Company, OM Financial Life is required by state regulation to maintain reserves equal to or greater than guaranteed surrender values.

Questions?

If you have any questions, call our service center at 888-513-8797.

Notes

This document is not a legal contract. For the exact terms and conditions, refer to the contract.

Form Numbers: FGL FPDA-ST (6-04); FGL FPDA-ST-C (6-04); FGL FPDA-ST (6-04) 10-10S; FGL FPDA-ST-C (6-04) 10-10S;et al.

Interest rates subject to change and are effective annual rates.

Indexed interest rates are subject to a cap

Annuities are a long-term investment to help with retirement income needs.

"Standard & Poor's®", "S&P®", "S&P 500®", "Standard & Poor's 500" and "500" are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by OM Financial Life Insurance Company. The product is not sponsored, endorsed, sold, or promoted by Standard & Poor's and Standard & Poor's makes no representation regarding the advisability of purchasing the product.

Policies issued by OM Financial Life Insurance Company, Baltimore, MD.

Instructions for Agent

OLD MUTUAL
INVEST INSURE INNOVATE

1. Review this brochure with the customer(s).
2. Have the customer(s) sign and date the Confirmation Statement.
3. In the box marked "For Agent Use", fill-in your name and address, and sign.
4. Detach and return the Confirmation Statement with the application to OM Financial Life.

If this is a 403(b) TSA transfer or rollover, please make sure the "Purpose of Annuity" block of the application looks like this:

	❍ ❍ Name ______ SSN ______
Plan	❍ Nonqualified ❍ Traditional IRA ❍ Roth IRA ❍ SEP IRA ⊗ Tax-Sheltered Annuity ❍ §401 ❍ Other (specify plan type): ______
Replacement	Do you have an existing life insurance or annuity policy? ❍ Yes ❍ No Will the annuity applied for replace or change an existing life insurance or annuity policy? ❍ Yes ❍ No *If a 1035 Exchange or 90-24 Transfer, attach applicable forms.* Transfer/Exchange Amount: $______ Policy/Certificate No.: ______ Company: ______
Premium/	1 Year S&P 500 Index – Monthly Pt-to-Pt w/Cap ____% of premium 1 Year S&P 500 Index – Monthly Avg. w/Cap ____% of premium **Initial/Single Premium Paid:** (premium paid with application)

Confirmation Statement

Please sign below to indicate your understanding. This form must be detached and returned with the application to OM Financial Life.

By signing here, you are telling us that you have read this summary and understand the descriptions of the Safety Index 10 indexed annuity features. You are also telling us that neither OM Financial Life nor your agent has made any guarantees or promises regarding future index values, index changes, index credits or interest rates under the annuity.

I understand that the Company offers index annuity products with different features and benefits and that I can also apply for those products by contacting the Company or one of its agents.

______________________ Signature of Owner ______ Date

______________________ Signature of Joint Owner, if any ______ Date

For Agent Use:

The agent has received a copy of, has carefully read and has complied with the Safety Index 10 Agent Training Manual and the OM Financial Life Market Conduct Guide.

______ Agent ______ Signature of Agent

______ Agency Address ______ City, State, Zip

☐ Option 1 ☐ Option 2 ☐ Option 3

Annuity Application

Product: Safety Index 10 ○ SPDA ● FPDA

OM Financial Life Insurance Company • Home Office: Baltimore, Maryland

Owner(s)

Name: ____________________ Joint Owner (if any): ____________________

SSN or TAX ID: ____________________ SSN or TAX ID: ____________________

○ Male ○ Female Birth Date: __________ ○ Male ○ Female Birth Date: __________

Address: ____________________ Address: ____________________

Phone No.: ( ) ____________ Phone No.: ( ) ____________

Relationship to Owner: ____________________

Annuitant(s)

(if other than Owner)

Name: ____________________ Joint/Contingent (if any): ____________________

SSN: ____________________ SSN: ____________________

○ Male ○ Female Birth Date: __________ ○ Male ○ Female Birth Date: __________

Address: ____________________ Address: ____________________

Beneficiary

Primary	Contingent				
○	○	Name	____________	SSN	________
○	○	Name	____________	SSN	________
○	○	Name	____________	SSN	________
○	○	Name	____________	SSN	________

Plan

○ Nonqualified ○ Traditional IRA ○ Roth IRA ○ SEP IRA ○ Tax-Sheltered Annuity

○ §401 ○ Other (specify plan type): ____________________

Replacement

Do you have an existing life insurance or annuity policy? ○ Yes ○ No

Will the annuity applied for replace or change an existing life insurance or annuity policy? ○ Yes ○ No

If a 1035 Exchange or 90-24 Transfer, attach applicable forms. Transfer/Exchange Amount: $__________

Policy/Certificate No.: ____________________ Company: ____________

Premium/ Option

Make check payable to OM Financial Life Insurance Company.

1 Year S&P 500 Index – Monthly Pt-to-Pt w/Cap	____% of premium	**Initial/Single Premium Paid:** (premium paid with application)
1 Year S&P 500 Index – Monthly Avg. w/Cap	____% of premium	$__________
1 Year S&P 500 Index – Annual Pt-to-Pt w/ Cap	____% of premium	Minimum of $2,000 per option.
1 Year S&P 500 Index – Monthly Avg. w/Spread	____% of premium	Whole percentages only.
Fixed Interest	____% of premium	Must equal 100%.

Special Instructions

____

I (We) have read the statements made in this application. To the best of my (our) knowledge and belief, the statements made are complete, true, and correctly recorded. I (We) understand that: a copy of this application page will form a part of any annuity issued; the annuity will not take effect until delivered to the Owner; and no agent has the authority to modify any annuity issued.

Fraud Warning Notice: Any person who knowingly and with intent to defraud any insurance company or other person files an application for insurance or statement of claim containing any materially false information or conceals for the purpose of misleading, information concerning any fact material thereto commits a fraudulent insurance act, which is a crime and may subject such person to criminal and civil penalties.

→ Signed at ____________________ Date: __________

→ Signature(s) of Owner(s): ____________ ____________

→ Signature(s) of Annuitant(s): ____________ ____________

Agent Use Only: Does the applicant have an existing life or annuity policy? ○ Yes ○ No

To the best of your knowledge, does this application replace or change existing life insurance or annuities? ○ Yes ○ No

I attest that I have witnessed all signatures.

Agent's Signature: ____________________ Date: __________

Print Agent's Name: ____________________ OM Financial Life Agent #: __________

Agent's Phone No.: ( ) __________ Agent's Fax No.: __________ Agent's Email Address: __________

Consider all the facts and alternatives, then make your own decision.

OM Financial Life offers a diverse portfolio of fixed and indexed interest and variable annuities and optional additional features. Before purchasing, consider your financial situation and alternatives available to you. Your *OM Financial Life financial professional* can help you determine the best alternatives for your goals and needs, or visit us at www.omfn.com for more information.

No financial institution guarantee. • Not FDIC/NCUA/NCUSIF insured. • May lose value if surrendered early.

OLD MUTUAL®

INVEST INSURE INNOVATE

THE THINKING IS NEW. THE NAME IS OLD MUTUAL.℠

Safety Index® 7

Old Mutual® is the marketing name of OM Financial Life Insurance Company, and in NY only, OM Financial Life Insurance Company of New York, Old Mutual plc companies.

Each Old Mutual company is solely responsible for its contractual commitments.

Fixed Indexed Annuity Protection and Growth Potential for Your Savings

OLD MUTUAL®
INVEST INSURE INNOVATE

Thank you for your interest in the SAFETY INDEX 7 annuity from OM Financial Life Insurance Company. SAFETY INDEX 7 has an adaptable combination of interest options for your retirement dollars, and offers terrific guarantees, such as a minimum guaranteed surrender value that is 100% of your premiums compounding at 3% (less a surrender charge). On the fixed option, the initial interest rate is GUARANTEED for seven years, and is guaranteed to be equal to or greater than 3% for the life of the policy! Additionally, you have the security of the annual reset feature, where any account gains are locked in at the end of each year – your account will never decrease in value! You also have riders to address unexpected contingencies such as unemployment, diagnosis of a terminal illness or nursing home confinement. OM Financial Life has prepared this summary to help you understand SAFETY INDEX 7's many options and advantages. Please confirm your understanding by signing the enclosed confirmation statement.

A Fixed Indexed Annuity

Safety Index 7 is a flexible premium deferred fixed indexed annuity with four interest indexed options and one fixed interest rate option. Safety Index 7 is designed to be a long-term retirement savings tool with many features to help you reach the standard of living you want during your retirement.

Tax Advantages

Although an annuity does not eliminate your tax liability on interest earnings, under current tax law all interest income earned accumulates on a tax-deferred basis. This tax deferral is currently available only to individual and joint owners, not to corporations or other non-individuals, under most circumstances. When purchased to fund a tax-qualified plan, there is no additional tax-deferral beyond that already provided by the plan; however, there may be other benefits worth considering.

A Choice of 5 Interest-Crediting Options

Safety Index 7 offers a choice of five interest crediting options. These options are 1-year monthly point-to-point with a cap,
1-year annual point-to-point with a cap, 1-year monthly average with a cap, 1-year monthly average with a spread and a fixed interest option. On the application, you can allocate your premiums among these five options. You may reallocate your account value between these options on each annuity anniversary.Interest rates are subject to change except as guaranteed.

Index Interest Options

If you choose to allocate some or all of your premiums to the index interest options, your interest credits will be credited annually based on formulas linked to changes in the monthly averaged or point-to-point values in the index, with each option subject to either a cap rate or spread rate. The cap rate is the maximum percentage applied on each anniversary as part of the total calculation for the annual index interest credit. The cap rate is declared in advance. The spread rate is a percentage declared in advance which is deducted as part of the calculation of the annual index interest credit. The monthly point-to-point index changes are subject to a cap that will never be less than one percent per month. The annual point-to-point and annual monthly average index changes are subject to caps that will never be less than three percent per year. The annual monthly average index spread rate will never be greater than nine percent per year. These index interest options may result in no interest credits, but the credit will never be less than zero.

Index interest credits are not calculated or credited between index interest crediting dates; consequently, amounts surrendered between index interest crediting dates will not earn any interest credits. Any interest credit is applied to your annuity on its annual anniversary and is locked-in, so future decreases in any index will not affect the interest already credited to your annuity.

Fixed Interest Crediting

If you choose to allocate some or all of your premium to the fixed-interest option, interest is credited daily. The issued annuity will show the credited interest rate applicable for the first seven years. After the initial guarantee period, we will declare a new current rate annually and will never credit less than 3%.

Minimum Guaranteed Surrender Value (MGSV)

Your Safety Index 7 annuity contains a protective floor that increases with interest on your cash surrender value for the index interest options. The minimum guaranteed surrender value on a full surrender is 100% of premium, plus daily interest accruing at 3% less any current surrender charges. MGSV is reduced by prior withdrawals and adjusted for any reallocations.

Payment in the Event of Death or Annuity Payout Options

Should you die before electing to receive income payments, the account value will be paid to the beneficiary named in your annuity. If you choose to receive annuity payments, and the annuity date is after the fifth certificate anniversary, we will apply the greater of the account value or the minimum guaranteed surrender value to the annuity option then in effect. If the annuity date is before the fifth certificate anniversary, we will apply the greater of the surrender value or the minimum guaranteed surrender value to the annuity option then in effect.

Guarantees are based upon the claims paying ability of the issuing company.

Account Value

The annuity's account value before the annuity date consists of the fixed interest option's account value plus the indexed interest options account value.

Surrender Value

For a full surrender, the surrender value is the greater of:

- Total account value, less surrender charges; or
- Total minimum guaranteed surrender value

No Initial Sales Charges or Fees

There are no initial sales charges or fees. Your full initial premium is available to earn interest from the date your annuity is issued. Annuities are issued with an issue date of the 1st, 8th, 15th and 22nd of each month. Premium checks will be held without interest, until the next available issue date. In order to be issued with the next available issue date, applications must be received no later than 5:00 p.m. (Eastern time) two business days prior to that issue date.

For special rules about issue dates that fall on holidays or weekends, contact OM Financial Life. The minimum initial premium is $15,000 and the minimum allocation to any option is $2,000.

How Index-Linked Interest Crediting Works

One-Year Monthly Point-to-Point with a Cap

The monthly point-to-point index change is determined by subtracting the prior month's index value from current month's index value and dividing it by the prior month's index value. If this results in a positive monthly point-to-point index change and is not more than the declared cap, then it is used as the index change for that month. If it is more than the declared cap, then we use the declared cap as the index change for that month. Negative monthly point-to-point index changes are also applicable.

An index change for each month is captured over a 12-month period. The sum of the 12 monthly index changes will be the index credit rate on the index crediting date. The index credit rate is multiplied by the option's account value to determine the index interest credit.

One-Year Annual Point-to-Point with a Cap

The annual point-to-point index change is determined by subtracting the prior year's index value from the current year's index value and dividing it by the prior year's index value. If this results in a positive annual point-to-point index change and is not more than the declared cap, then it is used as the index change for that year. If it is more than the declared cap, then we use the declared cap as the index change for that year.

A negative annual point-to-point index change is not subject to a cap. The index change will be the index credit rate on the index crediting date. The index credit rate is multiplied by the option's account value to determine the index interest credit.

One-Year Monthly Average with a Cap

The index values are measured at one-month intervals from the month after the prior anniversary to the month of the anniversary inclusive. The index average is the average of the index values of the twelve months during each year. The index change (which is calculated on the anniversary) is the index average minus the index value on the prior anniversary; divided by the index value on the prior anniversary. If the index change results in a positive index change and is not more than the declared cap, then it is used as the index change for that year. If it is more than the declared cap, then we use the declared cap as the index change for that year. This "averaging" formula helps smooth out the index values used to calculate your index-linked interest rate, which helps protect your interest rate gains from severe declines in the index during the interest crediting period. This averaging method may also reduce the amount of interest that could be earned if the index rises steadily throughout the year or increases sharply at the end of the year.

One-Year Monthly Average with a Spread

The index values are measured at one-month intervals from the month after the prior anniversary to the month of the anniversary inclusive. The index average is the average of the index values of the twelve months during each year. The index change (which is calculated on the anniversary) is the index average minus the index value on the prior anniversary; divided by the index value on the prior anniversary. A spread rate, declared annually, is deducted from the index change to determine the final index credit. This "averaging" formula helps smooth out the index values used to calculate your index-linked interest rate, which helps protect your interest rate gains from severe declines in the index during the interest crediting period. If the spread rate reaches 9%, the option would be suspended, and any funds in this option will be allocated uniformly across the remaining index interest options.

You are purchasing fixed index annuity that provides minimum guaranteed surrender values. You should understand how your minimum guaranteed surrender values are determined and the features of the product that are used to determine the values. Even though the values of the annuity may be affected by external indices, this product is not an investment in the stock market and does not participate in any stock, bond or indexed investments.

Hypothetical Examples

The following examples are not intended to be representations of past or future performance of Safety Index 7. These examples use hypothetical caps and index value changes.

Steadily increasing index

Assume the index rises steadily. Safety Index 7's index-linked formula results in the following interest credit for monthly point-to-point, monthly average, and annual point-to-point index options.

MONTHLY POINT-TO-POINT

Month	Index	Monthly Increase	Capped Increase *monthly cap rate = 3.00%*
1	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
3	911.20	0.21%	0.21%
[illegible]	[illegible]	[illegible]	[illegible]
5	914.40	0.12%	0.12%
[illegible]	[illegible]	[illegible]	[illegible]
7	922.80	0.16%	0.16%
[illegible]	[illegible]	[illegible]	[illegible]
9	928.10	0.21%	0.21%
[illegible]	[illegible]	[illegible]	[illegible]
11	947.30	1.13%	1.13%
[illegible]	[illegible]	[illegible]	[illegible]
13	972.10	2.01%	2.01%
Total of monthly capped increases			7.74%
Annual Interest Credit - Monthly Pt-to-Pt w/ a Cap			**7.74%**

ANNUAL PT-TO-PT

Date	Index	Increase	Capped Increase *annual cap rate = 9%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Annual Pt-to-Pt w/ a Cap			**8.01%**

MONTHLY AVG W/ CAP

Date	Index	Increase	Capped Increase *annual cap rate = 10%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Monthly Average w/ Cap			**3.29%**

MONTHLY AVG W/ SPREAD

Date	Index	Increase	Increase After Spread *annual spread rate = 1.5%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Monthly Average w/ Spread			**1.79%**

Sharply increasing index

Assume the index rises sharply. Safety Index 7's index-linked formula results in the following interest credit for monthly point-to-point, monthly average, and annual point-to-point index options.

MONTHLY POINT-TO-POINT

Month	Index	Monthly Increase	Capped Increase *monthly cap rate = 3.00%*
1	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
3	923.61	-0.22%	-0.22%
[illegible]	[illegible]	[illegible]	[illegible]
5	1004.96	7.01%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
7	1014.43	0.61%	0.61%
[illegible]	[illegible]	[illegible]	[illegible]
9	1041.15	0.79%	0.79%
[illegible]	[illegible]	[illegible]	[illegible]
11	1116.78	7.36%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
13	1126.51	0.28%	0.28%
Total of monthly capped increases			14.65%
Annual Interest Credit - Monthly Pt-to-Pt w/ a Cap			**14.65%**

ANNUAL PT-TO-PT

Date	Index	Increase	Capped Increase *annual cap rate = 9%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Annual Pt-to-Pt w/ a Cap			**9.00%**

MONTHLY AVG W/ CAP

Date	Index	Increase	Capped Increase *annual cap rate = 10%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Monthly Average w/ Cap			**10.00%**

MONTHLY AVG W/ SPREAD

Date	Index	Increase	Increase After Spread *annual spread rate = 1.5%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Monthly Average w/ Spread			**12.36%**

Upside Potential

Principal Protection

Minimum Interest Guaranteed on Surrender Value

Steadily increasing and a sharp drop in the index

Assume the index rises steadily, sharply drops and then sharply increases. Safety Index 7's index-linked formula results in the following interest credit for monthly point-to-point, monthly average, and annual point-to-point index options.

MONTHLY POINT-TO-POINT

Month	Index	Monthly Increase	Capped Increase *monthly cap rate = 3.00%*
1	900.00		
[illegible]	[illegible]	9.25%	[illegible]
3	1020.91	3.83%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
5	1118.87	8.21%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
7	1026.48	6.11%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
9	995.84	1.29%	1.29%
[illegible]	[illegible]	[illegible]	[illegible]
11	1077.38	6.16%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
13	1123.73	2.67%	2.67%
Total of monthly capped increases			5.98%
Annual Interest Credit - Monthly Pt-to-Pt w/ a Cap			**5.98%**

ANNUAL PT-TO-PT

Date	Index	Increase	Capped Increase *annual cap rate = 9%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Annual Pt-to-Pt w/ a Cap			**9.00%**

MONTHLY AVG W/ CAP

Date	Index	Increase	Capped Increase *annual cap rate = 10%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Monthly Average w/ Cap			**10.00%**

MONTHLY AVG W/ SPREAD

Date	Index	Increase	Increase After Spread *annual spread rate = 1.5%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Monthly Average w/ Spread			**13.69%**

Decreasing index

Assume the index decreases throughout the year and ends with a decrease. Safety Index 7's index-linked formula would result in a 0.00% credit instead of a negative credit for each of your four interest-crediting options.

MONTHLY POINT-TO-POINT

Month	Index	Monthly Increase	Capped Increase *monthly cap rate = 3.00%*
1	900.00		
[illegible]	803.25	-10.75%	[illegible]
3	834.01	3.83%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
5	914.04	8.21%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
7	838.56	6.11%	3.00%
[illegible]	[illegible]	[illegible]	[illegible]
9	813.54	1.29%	1.29%
[illegible]	[illegible]	[illegible]	[illegible]
11	780.43	1.46%	1.46%
[illegible]	[illegible]	[illegible]	[illegible]
13	809.68	2.67%	2.67%
Total of monthly capped increases			-17.21%
Annual Interest Credit - Monthly Pt-to-Pt w/ a Cap			**0.0%**

ANNUAL PT-TO-PT

Date	Index	Increase	Capped Increase *annual cap rate = 9%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Annual Pt-to-Pt w/ a Cap			**0.00%**

MONTHLY AVG W/ CAP

Date	Index	Increase	Capped Increase *annual cap rate = 10%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Monthly Average w/ Cap			**10.00%**

MONTHLY AVERAGE

Date	Index	Increase	Increase After Spread *annual spread rate = 1.5%*
Initial	900.00		
[illegible]	[illegible]	[illegible]	[illegible]
Annual Interest Credit - Monthly Average w/ Spread			**0.00%**

With the annual reset feature, all gains from previous years are locked in – your account will never decrease as long as no withdrawals are made!

When Surrender Charges Apply

The surrender charge applies for the first 7 years on full or partial surrenders (withdrawals), and in calculating the annuity payments unless it does not apply under the conditions below.

Surrender Charges

Annuity Year	Surrender Charge Percentage
1	10%
2	10%
3	10%
4	9%
5	8%
6	7%
7	6%
8	0%

The surrender charge equals the surrender charge percentage for the applicable year multiplied by the amount of account value withdrawn. Please review your annuity for the appropriate surrender charge schedule.

When Surrender Charges Do Not Apply

Surrender charges are not deducted from the account value when you request a surrender if any of the following benefits or situations, which may be provided by rider, are issued as part of or apply to your annuity:

1. You surrender 10% or less of the account value as of the prior policy anniversary, less any amounts previously surrendered in the current policy year which were not subject to surrender charges.
2. You exercise an annuity option after the 5th anniversary or later.
3. You are confined to a licensed nursing home for more than 60 days and the confinement begins after the first annuity year (the surrender must be made during the period of confinement).
4. A licensed physician certifies that you have been diagnosed with an illness or condition that causes your life expectancy to be less than one year (the diagnosis must be at least one year after the annuity's date of issue).
5. Your unemployment began after the date of issue, has continued for at least 30 consecutive days, and you are under the age of 65 at the time of your request (the surrender must be made during the period of unemployment).
6. When the death benefit is paid, unless the spouse of the first owner to die continues ownership of the annuity and subsequently surrenders the annuity.

Note that if you fully surrender the annuity or exercise one of the options because of the circumstances described above, the surrender value will equal the greater of the account value or the minimum guaranteed surrender value.

Taxation of Withdrawals

Withdrawals may be subject to income tax. If withdrawals are made before age 59½, they also may be subject to an IRS penalty tax. Please consult your tax advisor regarding your unique situation.

Minimum Required Distributions

Certain tax qualified annuities are subject to minimum required distributions which generally require that distributions begin no later than your attainment of age 70½ and that amounts be paid to you over a period not longer than your life expectancy.

Right to Examine Annuity

This annuity includes a right of examination period. This means that within the specified time period after you receive your annuity, you may return the annuity and receive a refund of 100% of the premium paid, minus any prior withdrawals.

Financial Security

Your annuity values are guaranteed solely by OM Financial Life Insurance Company. As a Legal reserve Company, OM Financial Life is required by state regulation to maintain reserves equal to or greater than guaranteed surrender values.

Questions?

If you have any questions, call our service center at 888-513-8797.

Notes

This document is not a legal contract. For the exact terms and conditions, refer to the contract.

Form Numbers: FGL FPDA-ST (6-04); FGL FPDA-ST-C (6-04); FGL FPDA-ST (6-04) 10-7S; FGL FPDA-ST-C (6-04) 10-7S; et al.

This product is offered on a group or individual basis as determined by state availability.

Subject to state availability. Certain restrictions may apply.

"Standard & Poor's®", "S&P®", "S&P 500®", "Standard & Poor's 500" and "500" are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by OM Financial Life Insurance Company. The product is not sponsored, endorsed, sold, or promoted by Standard & Poor's and Standard & Poor's makes no representation regarding the advisability of purchasing the product.

Policies issued by OM Financial Life Insurance Company, Baltimore, MD.

Instructions for Agent

OLD MUTUAL®
INVEST INSURE INNOVATE

1. Review this brochure with the customer(s).
2. Have the customer(s) sign and date the Confirmation Statement below.
3. In the box marked "For Agent Use," fill in your name and address, and sign below.
4. Detach and return this page with the application to OM Financial Life.

If this is a 403(b) TSA transfer or rollover, please make sure the "Purpose of Annuity" block of the application looks like this:

	❍	❍ Name		SSN	
Plan	❍ Nonqualified ❍ §401	❍ Traditional IRA ❍ Other (specify plan type):	❍ Roth IRA	❍ SEP IRA	X Tax-Sheltered Annuity
Replacement	Do you have an existing life insurance or annuity policy? ❍ Yes ❍ No Will the annuity applied for replace or change an existing life insurance or annuity policy? ❍ Yes ❍ No *If a 1035 Exchange or 90-24 Transfer, attach applicable forms.* Transfer/Exchange Amount: $ Policy/Certificate No.: Company:				
	1 Year S&P 500 Index – Monthly Pt-to-Pt w/Cap ____% of premium			**Initial/Single Premium Paid:**	

CONFIRMATION STATEMENT

Please sign below to indicate your understanding. This form must be detached and returned with the application to OM Financial Life.

By signing here, you are telling us that you have read this summary and understand the descriptions of the Safety Index 7 indexed annuity features. You are also telling us that neither OM Financial Life nor your agent has made any guarantees or promises regarding future index values, index changes, index credits or interest rates under the annuity.

I understand that the Company offers index annuity products with different features and benefits and that I can also apply for those products by contacting the Company or one of its agents.

➔ ______________________________ Signature of Owner ______________ Date

➔ ______________________________ Signature of Joint Owner, if any ______________ Date

For Agent Use:

The agent has received a copy of, has carefully read and has complied with the Safety Index 7 Agent Training Manual and the OM Financial Life Market Conduct Guide.

➔ ______________ Agent ______________ Signature of Agent

➔ ______________ Agency Address ______________ City, State, Zip

☐ Option 1 ☐ Option 2 ☐ Option 3

Annuity Application

Product: Safety Index 7 ❍ SPDA ● FPDA

OM Financial Life Insurance Company • Home Office: Baltimore, Maryland

Owner(s)

Name: ______________________ Joint Owner (if any): ______________________

SSN or TAX ID: ______________________ SSN or TAX ID: ______________________

❍ Male ❍ Female Birth Date: __________ ❍ Male ❍ Female Birth Date: __________

Address: ______________________ Address: ______________________

Phone No.: (______) ______________ Phone No.: (______) ______________

Relationship to Owner: ______________________

Annuitant(s)

(if other than Owner)

Name: ______________________ Joint/Contingent (if any): ______________________

SSN: ______________________ SSN: ______________________

❍ Male ❍ Female Birth Date: __________ ❍ Male ❍ Female Birth Date: __________

Address: ______________________ Address: ______________________

Beneficiary

Primary	Contingent				
❍	❍	Name	______________	SSN	__________
❍	❍	Name	______________	SSN	__________
❍	❍	Name	______________	SSN	__________
❍	❍	Name	______________	SSN	__________

Plan

❍ Nonqualified ❍ Traditional IRA ❍ Roth IRA ❍ SEP IRA ❍ Tax-Sheltered Annuity

❍ §401 ❍ Other (specify plan type): ______________________

Replacement

Do you have an existing life insurance or annuity policy? ❍ Yes ❍ No

Will the annuity applied for replace or change an existing life insurance or annuity policy? ❍ Yes ❍ No

If a 1035 Exchange or 90-24 Transfer, attach applicable forms. Transfer/Exchange Amount: $__________

Policy/Certificate No.: ______________________ Company: ______________

Premium/ Option

Make check payable to OM Financial Life Insurance Company.

1 Year S&P 500 Index – Monthly Pt-to-Pt w/Cap	_____% of premium
1 Year S&P 500 Index – Monthly Avg. w/Cap	_____% of premium
1 Year S&P 500 Index – Annual Pt-to-Pt w/ Cap	_____% of premium
1 Year S&P 500 Index – Monthly Avg. w/Spread	_____% of premium
Fixed Interest	_____% of premium

Initial/Single Premium Paid:
(premium paid with application)

$______________

Minimum of $2,000 per option.
Whole percentages only.
Must equal 100%.

Special Instructions

____

____

I (We) have read the statements made in this application. To the best of my (our) knowledge and belief, the statements made are complete, true, and correctly recorded. I (We) understand that: a copy of this application page will form a part of any annuity issued; the annuity will not take effect until delivered to the Owner; and no agent has the authority to modify any annuity issued.

Fraud Warning Notice: Any person who knowingly and with intent to defraud any insurance company or other person files an application for insurance or statement of claim containing any materially false information or conceals for the purpose of misleading, information concerning any fact material thereto commits a fraudulent insurance act, which is a crime and may subject such person to criminal and civil penalties.

→ Signed at ______________________________ Date: __________

→ Signature(s) of Owner(s): ______________ ______________

→ Signature(s) of Annuitant(s): ______________ ______________

Agent Use Only: Does the applicant have an existing life or annuity policy? ❍ Yes ❍ No

To the best of your knowledge, does this application replace or change existing life insurance or annuities? ❍ Yes ❍ No

I attest that I have witnessed all signatures.

Agent's Signature: ______________________________ Date: __________

Print Agent's Name: ______________________ OM Financial Life Agent #: ______________

Agent's Phone No.: (______) __________ Agent's Fax No.: ______________ Agent's Email Address: ______________

Thank You* for choosing a *SecurePlus Gold*. To acknowledge that you have read and the agent has explained how your Flexible Premium Indexed and Declared Interest Annuity works, please initial each page, and sign/date this summary at the end.

LSW's Multi-Account Indexed Annuity

SecurePlus Gold is an Indexed and Declared Interest Rate Annuity

SecurePlus Gold is a flexible premium deferred annuity† issued by Life Insurance Company of the Southwest (LSW). It is not a mutual fund, variable annuity, or any instrument that participates directly in stock or equity investments. Unlike mutual funds and stock or equity investments, *SecurePlus Gold* is an annuity with important insurance features, such as the tax deferral, Death Benefit**, and annuitization features. *SecurePlus Gold* also differs from variable annuities in that it offers protection from market loss, a feature not always found in variable annuities.

SecurePlus Gold will accept additional premiums at any time and has been designed for long-term retirement planning. *SecurePlus Gold* is generally similar to all other LSW fixed annuities except for the interest crediting features described later.

* *When we use the words "you" and "your" in this Summary, we mean the Owner of a SecurePlus Gold.*

† *SecurePlus Gold is LSW Policy Form Nos. 7912, 7918, and 7938.*

** *Some words and phrases that are capitalized in this document are defined in the policy form.*

 I have read and the agent has explained the information presented on this page. _______ (initial)

Tax-Deferred Accumulation*

SecurePlus Gold provides tax-deferred accumulation. All amounts in your annuity accumulate with federal income tax deferred until withdrawn. This tax deferral feature has two primary benefits. First, interest compounds on amounts you would otherwise pay in taxes during the accumulation period. Second, you may be in a lower tax bracket when you receive taxable interest than you are today.

You are liable for any tax on withdrawals. If you make a withdrawal before age 59½, you may be subject to an IRS 10% penalty.

This is our understanding of the current tax law. Neither LSW nor any of its agents or representatives give legal, tax, or accounting advice. Please consult your own tax advisor for tax advice.

Death Benefit

If you are the Annuitant and you die while this annuity is in force, LSW will pay the greater of the Accumulation Value or the Policy Value (these are described later) to your Beneficiary as a Death Benefit and will waive any remaining Withdrawal Charges. If you die and are the Owner but not the Annuitant, the Death Benefit will equal the Cash Value (this is described later). If death occurs after a Payment Option has been selected, any payments which remain to be paid under your election will be paid to your Beneficiary.

Annuitization

The Annuity Date is shown on Page 3 of your Policy. *SecurePlus Gold* guarantees that on the Annuity Date, you may choose to have the value of your annuity applied to provide a stream of payments. Your options range from a 10-year certain payout to a payment stream you cannot outlive. The amount of any payment depends in part on annuitization rates then in effect. Your *SecurePlus Gold* specifies certain guaranteed annuitization rates.

* *Annuities owned by trusts or corporate entities do not generally enjoy the tax deferral feature.*

SecurePlus Gold Accumulation Value

Premium Account
+
Interest Accounts
=
Accumulation Value

Each premium payment is placed in the Premium Account on the day received. The Premium Account is credited with interest to the next 21st of a calendar month (unless the premium is received on the 21st of a calendar month). Then we transfer, on the 21st of each calendar month, all amounts in the Premium Account to new Interest Accounts. We maintain each Interest Account separately. The period from the 21st of the month when an Interest Account is started to the 21st of the same month in the next year, and each one-year period thereafter, is an Account Year for that Account.

Premium Account Example

If you pay multiple premiums, your *SecurePlus Gold* will have a like number of Interest Accounts, each with its own Account Year. The sum of all Interest Accounts plus the Premium Account is your Accumulation Value.

Premium Account Example

If we receive a premium from you on September 27th, the premium is kept in the Premium Account, earning interest, until the next October 21st. Then the amount in the Premium Account is transferred to new Interest Account(s). Interest Accounts will have recurring Account Years that are measured from each October 21st to October 21st of the next following year.

Interest Crediting Options

An important feature of SecurePlus Gold is that you may choose among three methods to determine the interest credited to each of your Interest Accounts. The types of Interest Accounts available to you include Declared Interest Accounts and two Indexed Interest Accounts:

- Ending Index Indexed Interest Accounts (Ending Index Accounts)
  and
- Average Index Indexed Interest Accounts (Average Index Accounts)

Because you may pay multiple premiums, there can be multiple accounts of any of these types.

 I have read and the agent has explained the information presented on this page. ________ (initial)

Declared Interest Accounts

A Declared Interest Account is an Interest Account for which interest is credited daily at a declared effective annual interest rate. LSW sets the rate in advance each Account Year. The minimum annual effective rate is guaranteed to be at least 1.85%. Here is an example. None of the examples shown here are representations of the rates that LSW will actually credit to your *SecurePlus Gold* annuity.

Declared Interest Account Example

LSW declares an effective annual interest rate at the beginning of the Account Year of 4.75%. If the Declared Interest Account had been $10,000 at the beginning of the Account Year, in one year it would grow by $475 in interest, and the Declared Interest Account would have a value of $10,475 at the end of the Account Year. This would be the beginning value of the Declared Interest Account for the next Account Year.

Indexed Interest Accounts in General

Indexed Interest Accounts give you the potential to receive higher interest than might be the case with traditional fixed-rate annuities but without subjecting your retirement savings to market risk. Indexed Interest is credited annually based, in part, on the performance of the S&P 500® Index over the Account Year. All S&P 500 Index values (Index Values) are determined at the close of trading for the day.

To determine Indexed Interest credited to an Indexed Interest Account, we calculate an Annual Percentage Change at the end of the Account Year. This calculation is defined differently for Ending Index and Average Index Accounts.

The interest rate credited to all Indexed Interest Accounts is the Index Rate (sometimes called a "participation rate") multiplied by the Annual Percentage Change. The result is subject to a minimum called the Floor and a maximum known as the Cap.

- The Index Rate is the percentage of the Annual Percentage Change that is used as described above to determine the interest credited to an Indexed Interest Account. The Index Rate can never be less than 30%.
- The Cap is the maximum interest rate that may be credited to the Indexed Interest Account for the Account Year. It is guaranteed to be no less than 3%.
- The Floor is the minimum annual interest rate that may be credited to the Indexed Interest Account. The Floor can never be less than zero.

The Index Rate, Cap, and Floor for each Indexed Interest Account are set and guaranteed by LSW annually in advance at the beginning of each Account Year. The Index Rate, Cap, and Floor in effect for premiums paid at the time your annuity is issued will be shown in your annuity.

Ending Index Accounts

The Annual Percentage Change for an Ending Index Account is equal to the percentage change in the S&P 500 Index from the S&P 500 Index Value at the beginning of the Account Year to the Index Value at the end of the Account Year. The Index Rate, Cap, and Floor LSW determines for Ending Index Accounts may not be the same as those it determines for Average Index Accounts.

The following are examples of how interest is credited to Ending Index Accounts each Account Year. These examples are only demonstrations of how the formula works in different situations and are not representations of the rates that LSW will apply to your *SecurePlus Gold* annuity or of our expectations of the S&P 500 Index.

Ending Index Account Example 1

The S&P 500 Index is 1,000 at the beginning of the Account Year and is 1,050 at the end of the Account Year. The Annual Percentage Change is 5%.

LSW had declared an Index Rate for the Ending Index Account at the beginning of the Account Year of 75% (the minimum Index Rate is 30%), a Cap of 11% (the minimum Cap is 3%), and a Floor of 0%.

Multiply the Annual Percentage Change (5%) by the Index Rate (75%). The result is 3.75%. Is this more than the Cap of 11%? No. Is it less than the Floor of 0%? No. Then the result, 3.75%, is the interest rate applied to the Ending Index Account.

If the Ending Index Account had been $10,000 at the beginning of the year, it would be credited with $375 in interest at the end of the Account Year. Then, the Ending Index Account would have a value of $10,375 at the end of the Account Year. This value would also be the beginning value of the Ending Index Account for the next Account Year.

Ending Index Account Example 2

The S&P 500 Index is 1,200 at the beginning of the Account Year and is 1,500 at the end of the Account Year. The Annual Percentage Change is 25%.

LSW had declared an Index Rate for the Ending Index Account at the beginning of the Account Year of 80% (the minimum Index Rate is 30%), a Cap of 10% (the minimum Cap is 3%), and a Floor of 0%.

Multiply the Annual Percentage Change (25%) by the Index Rate (80%). The result is 20%. Is this more than the Cap of 10%? Yes. Then the rate of interest applied to the Ending Index Account for this Account Year is the Cap, 10%.

If the Ending Index Account had been $10,000 at the beginning of the year, it would be credited with $1,000 in interest at the end of the Account Year. Then, the Ending Index Account would have a value of $11,000 at the end of the Account Year. This value would also be the beginning value of the Ending Index Account for the next Account Year.

Here, the Cap was less than the Index Rate multiplied by the Annual Percentage Change. Thus, the interest was limited by the Cap.

Ending Index Account Example 3

The S&P 500 Index is 1,200 at the beginning of the Account Year and is 1,080 at the end of the Account Year. The Annual Percentage Change is -10% (minus 10%).

LSW had declared an Index Rate for the Ending Index Account at the beginning of the Account Year of 60% (the minimum Index Rate is 30%), a Cap of 12% (the minimum Cap is 3%), and a Floor of 0%.

Multiply the Annual Percentage Change (-10%) by the Index Rate (60%). The result is -6%. Is this more than the Cap of 12%? No. Is it less than the floor of 0%? Yes. Then the rate of interest applied to the Ending Index Account this Account Year is the Floor, 0%.

If the Ending Index Account had been $10,000 at the beginning of the year, it would remain at $10,000. This value would also be the beginning value for the Ending Index Account for the next Account Year.

Note that, in Example 3, the Ending Index Account retained its value even though the S&P 500 Index declined by 10% this Account Year. Increases in your Indexed Interest Accounts are locked in every year. This demonstrates one of the most important features of *SecurePlus Gold* – downside protection. Downside protection means there will be no decreases in the Indexed Interest Accounts due to a decrease in the S&P 500 Index. See the section on "What Happens if the S&P 500 Index Becomes Volatile?"

Average Index Accounts

The Annual Percentage Change for an Average Index Account is equal to the percentage change in the S&P 500 Index from the S&P 500 Index Value at the beginning of the Account Year to the average of the Index Values each day for every day the market is open during the Account Year. Because the S&P 500 Index does not move smoothly, the Annual Percentage Change for an Average Index Account may be higher or lower than the Annual Percentage Change for an Ending Index Account over the same time period.

There is no Cap for the Average Index Accounts for Account Years starting during the first 10 Policy Years. After the first 10 Policy Years, LSW will set the Cap in advance for each Account Year. The Cap is guaranteed to be at least 3%. The Index Rate, Cap, and Floor LSW determines for Average Index Accounts may not be the same as those it determines for otherwise identical Ending Index Accounts.

Let's examine two examples for the Average Index Account.

Average Index Account Example 1

The S&P 500 Index is 1,000 at the beginning of the Account Year. There are 250 trading days during the Account Year. The sum of the Index Values for each trading day during this time is 270,000. The average Index Value is 1,080. The Annual Percentage Change is 8%.

LSW had declared an Index Rate for the Average Index Account at the beginning of the Account Year of 90% (the minimum Index Rate is 30%), no Cap, and a Floor of 0%.

Multiply the Annual Percentage Change (8%) by the Index Rate (90%). The result is 7.20%. No Cap applies. Is the result less than the Floor of 0%? No. Then the result, 7.20%, is the interest rate applied to the Average Index Account.

If the Average Index Account had been $10,000 at the beginning of the year, it would be credited with $720 in interest at the end of the Account Year. Then, the Average Index Account would have a value of $10,720 at the end of the Account Year. This value would also be the beginning value of the Average Index Account for the next Account Year.

Remember, the Index Rates, Caps, and Floors may be different for an Average Index Account than for an Ending Index Account. The magnitude of differences may vary over time. These are only examples.

Average Index Account Example 2

The S&P 500 Index is 1,000 at the beginning of the Account Year. There are 250 trading days during the Account Year. The sum of all the Index Values during this time is 237,500. The average is, then, 950. The Annual Percentage Change is -5% (minus 5%).

LSW had declared an Index Rate for the Average Index Account at the beginning of the Account Year of 85% (the minimum Index Rate is 30%), no Cap, and a Floor of 0%.

Multiply the Annual Percentage Change (-5%) by the Index Rate (85%). The result is -4.25%. No Cap applies. Is the result less than the Floor of 0%? Yes. Then the rate of interest applied to the Average Index Account this year is the Floor, 0%.

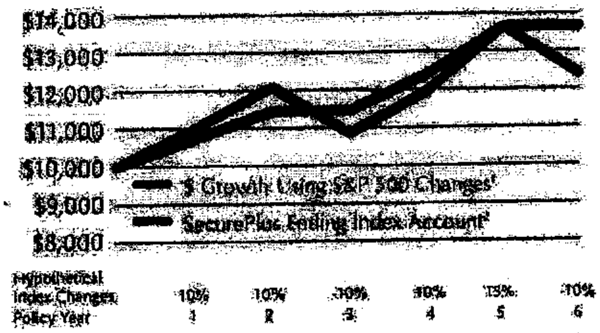
If the Average Index Account had been $10,000 at the beginning of the year, it would remain at $10,000. This value would also be the beginning value of the Average Index Account for the next Account Year.

What Happens if the S&P 500 Index Becomes Volatile?

As shown in the examples, interest previously credited to an Ending Index Account or an Average Index Account is not lost with *SecurePlus Gold* if the Annual Percentage Change is negative for any year. This interest crediting method is called the Ratchet Method. While direct investments in the marketplace must recover from a downturn, premium and credited interest in the *SecurePlus Gold* maintain their value. With *SecurePlus Gold*, a decline in the S&P 500 Index over an Account Year has no effect on the value of an Interest Account. The Index Value at the end of an Account Year becomes the beginning Index Value for the next Account Year – you have a fresh start. If the Annual Percentage Change determined at the end of the next Account Year is positive, you will earn interest on the change, even if the ending Index Value is lower than a level it reached in a prior Account Year.

Follow at right both the S&P 500 Index and a *SecurePlus Gold* Ending Index Account during a hypothetical six-year period to examine how the Ratchet Method of crediting interest is important to you. Again, this example is not meant to be representative of what will happen to your annuity.

Graph 1
Benefits of the ratchet method



Actual rates may vary and are subject to change without notice. Illustration is not representative of future results or of any applicable Index Rate. [1]Assumed changes without dividends. [2]Assumed 75% Index Rate, 10% Cap, 0% Floor. Withdrawal Charges apply for the first 10 years and are not reflected above.

We'll assume the Ending Index Account has a constant Index Rate of 75%, a Cap of 10%, and a Floor of zero. We'll track a single premium payment of $10,000 and see how it behaves and compare this with the same amount that tracks the S&P 500 Index itself. Graph 1 shows the results during this theoretical six-year period. Graph 1 illustrates two of the key features of the Ratchet Method, the potential for additional interest when the Index increases and protection of your account values when it decreases.

SecurePlus Gold uses the S&P 500 Index, an indicator widely used to measure the overall performance of the United States stock market *(equities)*. The S&P 500 Index is a market-value weighted price index which reflects capital growth only and does not include dividends paid on stocks.

We do not ever expect to change our index from the S&P 500 Index. If we ever have to, we will notify you and your state insurance department.

Premium Allocation

You indicate on your application how you wish to allocate your premium for the first Policy Year among the available Interest Accounts. After the first Policy Year, you may change the allocation for future premiums once each Policy Year. You may choose to distribute your premiums among any or all of the Interest Accounts. Your allocation must be whole percentages (for instance, 33%, 33%, and 34% respectively for the three available Interest Accounts). To change your allocations, you must do so in writing. New instructions become effective on the date we receive them and will apply to premiums received after that date.

Transfers Among Interest Accounts

Transfers between and among Interest Accounts may be made without charge. Amounts can be transferred from any type of Interest Account to another type of Interest Account only on the anniversary of the Interest Account from which the transfer is to be made and only after receipt of your written request for the transfer. Transfers from Interest Accounts are made on a LIFO basis (Last In, First Out). This means that the most recently opened Interest Accounts are transferred first. Your written request must be received 30 days before the transfer is to be made.

The rates applicable to the transferred amounts will be the same rates applied to premiums that had been in such Interest Accounts since the transfer premium was originally paid.

Following are brief examples of transferring money among accounts.

A new Interest Account is to be opened on July 21, 2005 with $100.00, and you direct that the amount be placed in a Declared Interest Account. Assume the rate applicable to the Declared Interest Account on July 21 is 5%. The value of the Account on July 21, 2006 would then be $105.00.

Prior to June 21, 2006 you request (in writing) that the entire amount in the Declared Interest Account be transferred to an Ending Index Account on July 21, 2006. On that date we will transfer the $105.00 from the Declared Interest Account to the Ending Index Account.

On July 21, 2006, LSW will set rates for all accounts that reset that day and will guarantee those rates for Account Years starting that day. For accounts that are one year old on that date, LSW might set a credited interest rate for the Declared Interest Account of 4.9% and an Index Rate of 70% and a Cap of 10% for the Ending Index Account. Note these renewal rates for monies with LSW may not be the same as the rates for Interest Accounts opened with transfers from the Premium Account on that day. They also may not be the same as the rates for Interest Accounts that are more than one year old.

The $105.00 in an Ending Index Account will start a new Account Year on July 21, 2006. Interest will be credited to the Ending Index Account on its next reset date, July 21, 2007, depending on the change in value of the S&P 500 Index between July 21, 2006 and July 21, 2007 given the Index Rate of 70% and Cap of 10% that were guaranteed at the beginning of the Account Year.

Assume you request by June 21, 2007 that the entire amount in the Ending Index Account be transferred to the Declared Interest Account. Assume the S&P 500 Index had increased 15% more from July 21, 2006 to July 21, 2007, and the amount credited to your Ending Index Account on July 21, 2007 is 10%. The $105.00 placed in the Ending Index Account on July 21, 2006 would have increased by $10.50 ($105.00 x 10%) in interest credited, and the amount in the Ending Index Account at the end of the Account Year would be $115.50. Per your instructions, we will transfer $115.50 to a Declared Interest Account for the next Account Year.

On July 21, 2007, LSW will set rates for all accounts being reset that day and will guarantee those rates for Account Years starting on that day. For accounts that are two years old on that date, LSW might set a credited interest rate for the Declared Interest Account of 4.85% and an Index Rate of 65% and a Cap of 10% for the Ending Index Account. *Note these rates may not be the same as the rates for Interest Accounts opened with transfers from the Premium Account on that day. They also may not be the same as the rates for Interest Accounts that are one year old or more than two years old, either.*

The $115.50 in a Declared Interest Account will start a new Account Year on July 21, 2007. Interest will be credited to the Account until July 21, 2008 at a rate of 4.85%.

Remember, the above are only an example of how the Policy operates and are not an indication of rates LSW will declare, the future of the S&P 500 Index, or amounts that may be credited to any of your Accounts.

Withdrawals

Partial Withdrawals may be taken from your annuity, subject to IRS rules. A Partial Withdrawal affects both the Accumulation Value and the Policy Value (described later). The Accumulation Value is reduced by the amount of the Partial Withdrawal including Withdrawal Charges assessed, if any.

Beginning in the second Policy Year and in each Policy Year thereafter, you may withdraw up to 10% of your annuity's Accumulation Value without a Withdrawal Charge (Free Withdrawal Amount). This feature is not cumulative. Any Withdrawal made during the first Policy Year will incur a Withdrawal Charge on the amount withdrawn. Withdrawals after the first Policy Year that exceed 10% of the annuity's Accumulation Value will incur a Withdrawal Charge on the excess over the Free Withdrawal Amount. Withdrawal Charges are applied as a percentage of the amount withdrawn in excess of the available Free Withdrawal Amount. There are no Withdrawal Charges after the 10th Policy Year.

If you elect to make a Total Withdrawal from your *SecurePlus Gold* annuity, we will pay you the Cash Value. The Cash Value is the greater of a) or b) where:

a) is the Accumulation Value minus a Withdrawal Charge, and

b) is the Policy Value defined below.

You may request that we pay the Cash Value under one of the Payment Options in your Policy. If you do so after the fifth Policy Year, we will provide an annuity based on the calculation of the Cash Value without application of Withdrawal Charges.

Because of the Withdrawal Charge, withdrawals from your *SecurePlus Gold* during the first 10 Policy Years could result in a loss of a portion of your premiums paid. See Table 1 below.

Table 1
Withdrawal Charges

Policy Year	1	2	3	4	5	6	7	8	9	10	11+
Withdrawal Charge %	10	9	8	7	6	5	4	3	2	1	0

Policy Value

SecurePlus Gold provides a guaranteed minimum value to your annuity, called the Policy Value. The Death Benefit, the annuitization benefit, and the Cash Value can never be less than the Policy Value.

The calculation of the Policy Value is independent of the calculation of the Accumulation Value for the first 10 Policy Years. The minimum Policy Value is equal to the accumulation of 90% of each premium at an annual rate of at least 1.95%, reduced by Partial Withdrawals, but not by any Withdrawal Charges assessed to the Accumulation Value.

On the 10th anniversary of the issue date and annually thereafter, the Policy Value may be increased by Excess Interest. Excess interest is the excess of a) over b) where:

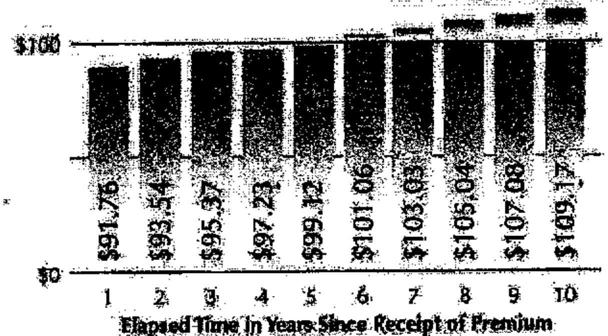
a) is total interest credited to the Accumulation Value since issue of the Policy, and

b) is total interest credited to the Policy Value since issue of the Policy.

Once Excess Interest is credited to the Policy Value, it becomes part of the Policy Value and earns interest at an annual rate of at least 1.95%.

No matter what the performance of the S&P 500 Index may be, *SecurePlus Gold* assures you that, six years after the date each premium is received, the Policy Value attributable to it will be greater than the amount of such premium. This is so, even if the S&P 500 Index Annual Percentage Change declines every year. Graph 2 shows the guaranteed minimum value for the first 10 years following payment for every $100 of premium.

Graph 2
Guaranteed Minimum Policy Value
for Every $100 in Premium Paid



Right to Examine This Policy

You have a right to a complete refund of your total premium payments at any time within 30 days of receiving your annuity Policy. To exercise this right, you must return your Policy with a written request for a refund.

Premium Taxes

Some states charge a premium tax on annuities. A few states levy the tax when you pay a premium. Others charge it upon withdrawal or selection of a Payment Option. If we must pay this tax, we will deduct it from your Policy benefits.

Questions?

If you have questions, you may ask them of your agent. You may also call our Home Office. Our telephone number is 800-579-2878. When you call, please say that you have questions about your SecurePlus Gold Indexed and Declared Interest Rate Annuity. We will be glad to hear from you.

Please Tell Us If You Understand

Please do not rely on any statements about *SecurePlus Gold* that are not consistent with what is described in this Summary, in the annuity Policy form, or in other material published by LSW. In case of any ambiguity, conflict, or question regarding interpretation of this Summary or any other published material or statements, the provisions of the Policy form prevail. Please consult your annuity Policy form for further details.

 I have read and the agent has explained the information presented on this page. ________ (initial)

Disclosure Understanding/Purchase Recommendation

1. Purchase Recommendation
(Agent must initial 1a or 1b.)

__________ a. By my signature at right as Agent and by
Agent Initials

my initial here, I recommend this annuity for purchase by the Owner. I have reasonable grounds for believing this recommendation is suitable based on the facts disclosed by Owner as to his/her investments, other insurance products, and financial situation needs. I will maintain and will make available to LSW or any insurance department, upon demand by either, a copy of information collected and a listing of other information used as the basis for this recommendation for the length of time required by applicable state law. Any process that accurately reproduces the actual document may be used to maintain these records.

(If Agent has initialed 1a, proceed to #2 at right. Otherwise, Agent must initial 1b below, and Owner must then initial 1c below.)

__________ b. By signature at right as Agent and by my
Agent Initials

initial here, I acknowledge that I have not received adequate information from the owner to make a recommendation as to the purchase of this annuity, and the owner is proceeding based on owner's own judgment.

__________ c. By my signature at right as Owner and
Owner Initials

by my initial here, I acknowledge responsibility for the suitability of this annuity purchase for my needs. I elect not to provide the information necessary for Agent to make a recommendation to make this purchase or exchange. I have decided to enter into this annuity purchase without a recommendation from Agent.

"Standard & Poor's®", "S&P®", "S&P 500®", "Standard & Poor's 500", and "500" are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by Life Insurance Company of the Southwest. The product is not sponsored, endorsed, sold or promoted by Standard & Poor's and Standard & Poor's makes no representation regarding the advisability of purchasing the product.

The Russell 2000® Index is a trademark of the Russell Investment Group and has been licensed for use by Life Insurance Company of the Southwest. This product is not sponsored, endorsed, sold or promoted by the Russell Investment Group and Russell Investment Group makes no representation regarding the advisability of purchasing the Product.

2. Understanding

My signature as "Owner" below acknowledges that I have read and the agent has explained the contents of this Summary. I initialed each page as it was reviewed. I understand this original Summary will be enclosed with my application and a copy of it will be sent with my Policy.

____
Print Owner Name

____
Owner Signature Date

____
Print Agent Name Agent No.

____
Agent Signature Date

Thank You.
We Appreciate Your Business and Your Confidence in LSW.

Life Insurance Company of the Southwest

NATIONAL LIFE GROUP®

LSW Home Office: 1300 West Mockingbird Lane, Dallas, Texas 75247
Telephone: 800-579-2878 / www.lifeofsouthwest.com

National Life Home Office: One National Life Drive
Montpelier, Vermont 05604 / Telephone: 800-277-9929
www.nationallife.com

National Life Group is a trade name of National Life Insurance Company and its affiliates. Each company of the National Life Group is solely responsible for its own financial condition and contractual obligations. LSW is not authorized to sell insurance in New York and does not do any insurance business in New York.

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

NOTE: PLEASE REMOVE THIS FORM FROM PACKET BEFORE COMPLETING THE APPLICATION.

[redacted]

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

Allianz

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

NOTE: PLEASE REMOVE THIS FORM FROM PACKET BEFORE COMPLETING THE APPLICATION.

[redacted]

Annuity Suitability Acknowledgement Form

OLD MUTUAL
INVEST INSURE INNOVATE

INSURER – OM Financial Life Insurance Company

1. **THIS FORM HELPS YOU.** It is important you have the information you need to determine if purchasing a fixed annuity contract meets your needs for your financial situation. This form can help you make that determination.

2. **CUSTOMER PROFILE**

Owner's Name ____________________ Age ______ Occupation __________________________

Monthly Disposable Income (***monthly income minus monthly expenses***): ________________

Net worth excluding equity in primary residence: _________________

What is your marginal federal tax rate? ___ 0% ___ 10% ___ 15% ___ 25% ___ 28% ___ 33% ___ 35%

Which goal is most important to you with respect to this OM Life Annuity you are purchasing?

__ Retirement __ Principal Protection __ Tax Deferral __ Wealth Accumulation __ Emergencies __ College Funding

__ Guaranteed Income __ Vacations

Please list the amount of current savings and investments below:

Checking/Savings/Money Market	$________	Primary Residence	$________
Certificates of Deposit	$________	Other Real Estate	$________
Fixed Annuities	$________	Mutual Funds	$________
Variable Annuities	$________	Stocks/Bonds	$________
Life Insurance Cash Value	$________	Retirement Plans	$________

This annuity transaction represents approximately what percentage of your assets (excluding primary home)?

☐ 0 – 25% ☐ 25% - 50% ☐ 50% - 75% ☐ 75% - 100%

Is this a replacement of an annuity or a life contract/? ____ Yes ____ No

a) **If yes**, is there a penalty for early termination (surrender charge)? _____ Yes _____ No
b) If there is a penalty or surrender charge, what percentage of the contract value being replaced will be subject to a penalty? ___0-2% ___ 3-5% ___ 6-8% ___ 9% or >

3. **ACKNOWLEDGEMENT AND SIGNATURE**

I understand that:

- I have applied for and/or purchased an annuity contract. This is NOT a short-term savings vehicle.
- The premiums I pay for the annuity contract apply to a fixed annuity contract – not a mutual fund, savings account, certificate of deposit, security or other financial product.
- Certain cash withdrawals from, or a complete surrender of, the contract are subject to certain limitations and charges as described in the contract. I understand that the annuity contract permits certain charge–free withdrawal amounts; I believe these amounts are more than sufficient to meet my income and other financial needs.
- Surrender/redemption charges/fees may be incurred as a result of liquidating existing accounts in order to fund this annuity.
- Income tax liability may be incurred as a result of withdrawals and/or liquidating my existing accounts; however, I believe this transaction to be in my best interest.
- The Agent/Representative and OM Financial Life may not offer tax advice, and I am responsible for the tax consequences, if any, related to this transaction. If needed, I will consult with my own professional tax advisor.
- The Agent/Representative and OM Financial Life may rely upon the information provided herein, and the information provided herein is true and accurate to the best of my knowledge.
- I value the product features this contract provides, including its guarantees.

______________________________ ______________________
Owner's Signature Date

______________________________ ______________________
Joint Owner's Signature (if applicable) Date

______________________________ ______________________
Agent Signature Date

AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY
P.O. Box 71216
Des Moines, IA 50325
888-221-1234
Fax 515-221-9947
www.american-equity.com

SUITABILITY ACKNOWLEDGEMENT

This form will assist you and your agent in determining if an American Equity annuity meets your particular financial situation. You have the legal right to decline to answer the questions below, however please be advised American Equity may elect not to issue the annuity contract for which you are applying.

Personal Information

Owner/Applicant Full Name	Joint Owner/Applicant Full Name
Owner/Applicant Occupation	Joint Owner/Applicant Occupation

Financial Information

1. Source of funds used to purchase this annuity:____________________
2. Estimated combined State and Federal Tax Bracket:____________________%
3. Estimated Net Worth (excluding home(s) and automobile(s)):$____________________
4. Approximate Gross Income
   ❑ $0 to $49,999 ❑ $50,000 to $99,999 ❑ Over $100,000
5. Financial Objectives (*Check all that apply*)
   ❑ Safety of Premium ❑ Death Benefit Options ❑ Supplement Retirement Income
   ❑ Probate Avoidance ❑ Tax Deferral ❑ Other____________
   ❑ Guarantees ❑ Diversity of Interest Crediting Strategies
6. Withdrawal options & surrender charge period were fully explained to me by my agent....❑ Yes ❑ No
7. Do you have sufficient liquid assets available for monthly living expenses and emergencies other than the money you plan to use to purchase this annuity contract? ....❑ **Yes** ❑ **No**
   Initial ____________
8. Are you using funds from an existing life insurance policy or annuity contract?................❑ Yes ❑ No
   a. If "yes", how long has the policy or contract been in force? ____________________
9. If you answered "yes" to question 8, *is there a surrender charge assessed with the* existing policy or contract? ....❑ Yes ❑ No
   a. If "yes", what is the percentage? ____________%

❑ I have declined to provide some or all of the answers to the above questions.

By signing below, I acknowledge that this fixed annuity product meets my long-term financial objectives. I acknowledge my agent has fully explained the surrender charges and surrender period and I have reviewed the applicable disclosure statement with my agent in determining this fixed annuity product is suitable for my financial situation.

______________________________ ____________
Owner/Applicant's Signature Date

______________________________ ____________
Joint Owner/Applicant's Signature Date

Agent's Statement

❑ I have provided the Owner/Applicant a copy of the Product Disclosure for this product. Also, I have not made representations or promises about the future values of this contract that differ from the company provided materials.

❑ I have reviewed the client's financial information and acknowledge this annuity meets the client's financial needs and objectives.

❑ I have reviewed government issued photo identification for the Owner and Annuitant.

______________________________ ____________
Agent's Signature Date

SUBMIT WITH APPLICATION

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

Deferred Annuity Suitability Form

Thank you for your interest in a Midland National Annuity. Before we can process your application and issue your contract, we would like to confirm that your annuity purchase suits your current financial situation and long-term goals.

Please note that if this form is not completed in full, signed, and dated, we are unable to consider your application.

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

Applicant/Owner's First Name ☐☐☐☐☐☐☐☐☐☐ MI ☐ Last Name ☐☐☐☐☐☐☐☐☐☐☐☐☐ Midland National Contract Number (if assigned) ☐☐☐☐☐☐☐☐☐☐

Joint Applicant/Owner's First Name ☐☐☐☐☐☐☐☐☐☐ MI ☐ Last Name ☐☐☐☐☐☐☐☐☐☐☐☐☐

A. FINANCIAL AND TAX STATUS

1. Annual household income: $ ☐☐☐☐☐☐☐☐☐☐☐ .00
2. Federal Income Tax Bracket (estimated): ☐ 0% ☐ 10% ☐ 15% ☐ 25% ☐ 28% ☐ 33% ☐ 35%
3. Net Worth: $ ☐☐☐☐☐☐☐☐☐☐☐ .00 (exclude primary residence)
4. Source of Funds for the purchase of this annuity (check all that apply): ☐ Stocks/Bonds/ Mutual Funds ☐ Pension ☐ Annuity ☐ Checking/Savings ☐ Life Insurance ☐ Bank CD ☐ Other ____________
5. Did your agent review your net worth, financial and tax status, investment objectives, and financial objectives before recommending this annuity? ☐ Yes ☐ No
6. After considering your net worth, source of funds, liquidity needs, and time horizon do you believe this deferred annuity contract is suitable for your financial situation and objectives? ☐ Yes ☐ No

B. FINANCIAL OBJECTIVES

1. My financial objective(s) for purchasing this annuity (check all that apply): ☐ Tax Deferral ☐ Guarantees provided ☐ Long-term growth, followed by income ☐ Long-term growth, with a transfer of assets to beneficiary at death ☐ Immediate annuity (Complete form 11796Y instead). ☐ Other ____________
2. Do you have sufficient funds available for monthly living expenses, medical expenses and emergencies other than the funds planned for this annuity or any other annuities already owned? ☐ Yes ☐ No
3. An annuity is a long-term contract with substantial penalties for early surrenders and/or withdrawals. Other than penalty-free withdrawals, do you currently anticipate taking any other withdrawals during the surrender charge period? ☐ Yes ☐ No
   If Yes, please explain how and when: ____________
4. Do you understand that if you take money out of this annuity, in excess of the penalty-free withdrawal, during the surrender charge period, that you will incur a surrender charge and interest adjustment (if applicable)? ☐ Yes ☐ No
5. Will a trust be named as the Owner or Beneficiary of this annuity contract? ☐ Yes ☐ No
   If "NO", skip to Section C. If "YES", answer question 6.
6. I understand that the purchase of this annuity contract is in no way required in conjunction with the establishment of a Trust and that any fees, costs and/or expenses associated with the establishment or maintenance of the Trust are independent of any premium paid for the purchase of this annuity. ☐ Yes ☐ No

C. REPLACEMENT

☐ Not applicable - not replacing or changing an existing life insurance or annuity contract to fund this purchase (skip to D).

1. What is the remaining surrender charge associated with the existing contract?
(Please attach an additional sheet if more than three contracts will be replaced.)

   a. ☐☐ % Company Name ______________________________

   b. ☐☐ % Company Name ______________________________

   c. ☐☐ % Company Name ______________________________

2. Are you using a penalty free withdrawal from your existing contracts to purchase this annuity? .... ☐ Yes ☐ No

3. Are you required to annuitize (elect a series of scheduled payments) your existing contract in order for you or your beneficiary to receive the full accumulation value without surrender charges? .... ☐ Yes ☐ No

4. I agree that my agent has explained how the existing and new contracts compare concerning surrender charges, interest rates, company ratings and all other benefits and features. .... ☐ Yes ☐ No

5. Replacement Reason (required) - My reason(s) for choosing this replacement contract *(attach an additional sheet if necessary).*
   ☐ Company Rating of Midland National ☐ Interest Rates/Index Credit Potential ☐ Penalty-free Death Benefit
   ☐ Change in Financial Objective ☐ Enhanced Benefits ☐ Increased Liquidity ☐ Multiple Index Options
   ☐ Other - Please Explain ______________________________

6. Is your current agent the same agent who recommended the purchase of the existing annuity or life insurance contract? .... ☐ Yes ☐ No

D. APPLICANT / OWNER SIGNATURE

By signing below, I certify that: 1) to the best of my knowledge and belief, the information provided to my agent, and shown above is true and complete; 2) the annuity meets my financial needs and objectives; and 3) this annuity is suitable for me.

Applicant/Owner Signature: ______________________________ **Date:** ☐☐ / ☐☐ / ☐☐☐☐

Joint Applicant/Owner Signature: ______________________________ **Date:** ☐☐ / ☐☐ / ☐☐☐☐

E. AGENT STATEMENT
- ACKNOWLEDGEMENT OF RESPONSIBILITY FOR SUITABILITY RECOMMENDATIONS

By signing below, I certify that:
1) I have completed a suitability and needs analysis review regarding the purchase of this annuity;
2) I have reasonable grounds for believing that the recommendation to purchase this annuity is suitable for the Applicant/Owner; and
3) I agree to maintain records of the information provided by the Applicant/Owner and any other information used as the basis for my recommendation. I agree to make such records available for review upon request by Midland National or by any regulatory body as required.

Agent Signature: ______________________________

Agent Number: ☐☐☐☐☐☐☐☐☐☐ **Date:** ☐☐ / ☐☐ / ☐☐☐☐