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July 11, 2008

The Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

I am writing concerning File Number S7-14-08.

The key problem with proposed rule 151A is that it burdens and imperils access to an insurance product that has for years demonstrated significant public demand. Accepting the status quo – that indexed annuities currently are insurance products – rule 151A would place an insurance product under the securities regulatory bureaucracy - a bureaucracy that has neither the training nor the necessary experience to understand insurance product benefits or markets.

The Securities Industry Does Not Understand Indexed Annuities
This lack of understanding can be abundantly attested to by the variety of complaints from all manner of securities industry stakeholders over the last few years. The outcry of the securities industry from securities salespeople to state securities regulators to NASAA and FINRA chairmen has been loud and continuous. For all its ferocity, however, it is surprisingly not matched by the volume of consumer complaints made to state insurance departments nor by flagging public demand. Neither is there a similar outcry from the National Association of Insurance Commissioners nor the American Academy of Actuaries.

The Chairman's comments introducing this rule echo the same criticisms leveled by SEC constituents, namely that indexed annuities are complex, pay outsized commissions, have high surrender charges and place investment risks similar to variable annuities upon their buyers. To place an insurance product so reviled under a regulatory scheme that does not value or understand it can neither the protect investors nor enhance market efficiency. This rule will kill the indexed annuity industry as we know it.

Promotion of Competition a Key SEC Directive
The promotion of efficiency and competition are primary directives for the Securities Commission as explained by Congress in the Securities Act of 1933 section 2b

> "Whenever pursuant to this [Act] the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in

> the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."

The guidance provided here is among the very first given in this historic and foundational Act. As such, efficiency, competition and capital formation must have been primary interests of congress in its writing. These three interests should be controlling in any rulemaking the SEC undertakes, yet I find the proposed rule 151A to be clearly anti-competitive.

Indexed Annuities: The Insurance Industry's Alternative

Since the mid 1990's the SEC has been cognizant of indexed annuities and in 1997 undertook a formal process of hearing public comment on the nature of this product. At that time, the SEC chose to abstain from any rulemaking. In 2003 the NAIC modified these laws requiring higher guarantees of all fixed and indexed annuities. More recently, states have begun enacting suitability requirements – ensuring that these annuites are sold properly. Beyond these two items, since 1997, little else has changed in the marketing or regulation of indexed annuities. However, the securities market has changed dramatically.

During the 1990's, drawn by the historic bull market, the percentage of the US public invested in securities more than doubled. Many of these newer investors were ignorant of the risks of market volatility. In the years 2000 to 2002, most owners of securities lost significant value in their holdings. This loss was particularly devastating to senior citizens whose holdings often represented both their life savings and their retirement assets. In the years following these losses, billions of dollars flowed out of securities and into the guaranteed, insured indexed annuity.

State nonforfeiture laws enacted in nearly every state in the country prescribe a minimum cash value that every indexed annuities (and fixed annuities) return to their owners. In addition, competition drove many companies to offer guarantees well in excess of the guarantees required by law. These minimum guarantees together with the other provisions of indexed annuities that responded to investors fears and drew so many billions of assets into these insured products.

This flow of assets out of securities and into indexed annuities at the rates over $20 billion annually for the last several years has not gone unnoticed by securities salespeople. Why is it that NASAA and FINRA are finding indexed annuities to be so troublesome and yet neither the owners of indexed annuities nor the insurance regulatory bodies are? I propose the answer is that it is not the indexed annuity owners, but the securities sales people who are complaining to their regulators. Dollars are flowing out from under their management. Indexed annuity owners, by contrast have received record interest credits over the last five years – while maintaining nearly no risk of loss.

I would suggest that the chairman's four complaints of complexity, high commissions, high surrender charges and market risk are the justifications for, but not the impetus of this proposed rule.

Market Risk

As has been mentioned earlier, nonforfeiture laws in nearly every state limit a policy owner's loss due to market volatility or any other force. Under today's conditions, a typical ten year policy surrendered five years early cannot by law return less than 97% of its original principal. This minimum standard is the same standard set for traditional fixed annuities.

Furthermore, nearly every indexed annuity sold today includes the provision that market performance can neither invade principal nor prior credited interest. Said another way, interest credits cannot be negative – only positive or zero. This provision, together with the minimum guarantees mentioned above, distinguish the indexed annuity as insurance.

Actuaries are the insurance industry's mathematicians and risk technicians. The Actuarial Profession's mouthpiece is the American Academy of Actuaries. In 2005, they submitted to the SEC a comprehensive opinion on the nature of indexed annuities. In their final comments, they concluded as follows:

> *From a technical perspective we have noted that an EIA provides to a purchaser guarantees and other conditions that are quite similar to those on a fixed-rate annuity. Similarly, the method in which an insurer financially manages the product and realizes financial results is essentially the same as that for a fixed-rate annuity. The combination of these perspectives indicates that nonregistered EIAs operate like fixed-rate annuities and thus have characteristics that support their status as nonregistered products.*

I have attached the full text of this document to this letter.

High Surrender Charges

Surrender charges are limited by the same nonforfeiture laws mentioned above. Neither early surrender, nor market risk are allowed by law to drive cash values below the legally prescribed minimums.

In addition, surrender charges are not unique to indexed annuities. Traditional fixed annuities have surrender charges of equal magnitude because both products are subject to the same insurance law.

Surrender charges are assessed when a fixed or indexed annuity is not held to its term of usually 5 to 12 years. They have two purposes. First, they recover sales costs that would have been amortized over the term. In the case that an annuity is not held to term, the amortization is not complete and the surrender charge recovers the remaining, unamortized cost. Second, surrender charges protect the insurance company. The assets invested by the insurance company both for fixed and indexed annuities are bonds of a term approximating the term of the annuity policy. If the policy is surrendered early, the company may be forced to sell the bonds at a loss to generate the proceeds to the policy owner. Surrender charges help cover that risk for the insurance company.

High Commissions

Commissions are generally driven by market forces. Surveys done by Advantage Compendium find that the average indexed annuity commission paid to the insurance agent is 8% today. There are policies that offer higher and lower commissions.

By comparison, a typical securities sales person might receive 1% of the assets they manage each year. Over the same term of 5 to 12 years, the commissions paid to both insurance and securities agents are actually quite comparable.

Although regulation could be enacted to squeeze the commissions paid to a narrower range, I believe market forces and company controls are working to provide annuities to the public in an efficient manner.

Complexity

All insurance is at some level complex. Even traditional universal life insurance with its interest credits, insurance charges, loads, cash values can be a complex product to understand. At issue here is the ability for the customer to understand his or her indexed annuity purchase. Securities are also highly complex financial instruments.

The indexed annuity value proposition is something like this: This annuity has a term of (5 to 12) years. During this time you will be able to access up to 10% of each year without penalty. If you surrender your policy early, you are guaranteed to receive no less than the guarantee provided by law (or by the insurance contract if higher). Each year you will be credited interest that is no less than zero. The actual interest will be tied to an external index (such as the S&P 500). If the S&P increases, you will receive (50% of the increase, or all the increase up to 9%). If the S&P decreases, you will receive no interest that year.

I find this explanation to be generally complete for most annuities and less complex than many other forms of insurance regulated at the state level.

Conclusion

The US Supreme Court, in the case that determined Variable Annuities to be securities (SEC vs. VALIC), began their reasoning as follows:

> "We start with a 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, has traditionally been under the control of the States."

I would encourage the SEC to consider whether propose rule 151A was crafted with the appropriate "reluctance to disturb state regulatory schemes that are in actual effect."

I would encourage the SEC to read and consider the professional opinion of the American Academy of Actuaries who may be knowledgeable concerning the technical aspects of indexed annuities.

I would encourage the SEC to consider the source of the complaints they are hearing concerning indexed annuities and the possible motivations behind them – to consider whether this rule is a just response to these complaints.

I would encourage the SEC to consider the thousands of careers and small business ventures that would be harmed or destroyed by enacting this rule.

I would encourage the SEC to consider the guidance laid down by congress in the Securities Act of 1933 – to take appropriate measures to foster competition and efficiency – and to reach for the hammer of federal regulation with due care.

And finally, I would recommend that the SEC consider whether FINRA (formerly NASD) had in fact overstepped its authority in 2005, enacting Notice to Members 05-50. This notice recommends that broker-dealers untrained in and unfamiliar with insurance oversee the sales of indexed annuities which were known at that time to be insurance products and thereby not subject to NASD purview.

With Concern,

Matthew Coleman, FSA, MAAA
Managing Principal & Actuary
AnnuityWorks, LLC

December 21, 2005

Susan Nash
Associate Director
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0506

Re: Comments to the Securities and Exchange Commission Concerning Equity-Indexed Annuities

Dear Ms. Nash:

The July 2005 request from the Securities and Exchange Commission (SEC) of insurers that are the major writers of equity-indexed annuities (EIA) suggested to us that the SEC is again interested in considering the issues of what are the characteristics of an EIA and whether an EIA is a security. When the SEC previously addressed these issues with its "Concept Release" in August 1997, the American Academy of Actuaries (Academy) submitted comments. While not solicited by the SEC at this time, the Academy offers these submitted comments as additional background for the current review of EIAs.

We have reviewed and evaluated the characteristics of currently available EIAs, from the perspective of both the purchaser and the insurer. The review includes the risks (or mitigation thereof) of guarantees, the options available to the insurer and purchaser and who controls the assets supporting the EIA contract. We then specifically compare the characteristics of EIAs to fixed-rate annuities and variable annuities (VAs) in order to best illustrate why EIAs are most appropriately regarded as fixed annuities.

EIAs from a Purchaser's Perspective

<u>Contract Characteristics</u>
An EIA that is not registered as a security is a product that is supported by the insurer's general account. Since the Standard Nonforfeiture Law for Individual Deferred Annuities (SNFLIDA) requires general account products to provide a minimum level of guaranteed interest, these EIAs are sold with interest crediting guarantees. This differentiates these EIAs from separate account products, such as a variable annuity, that transfers all or most of the investment risk to the purchaser.

Current Interest Crediting Guarantee

During each interest-crediting period, whether a single year or a multi-year period, the terms of the EIA interest crediting are guaranteed in advance. The participation rate, cap, or spread fee is determined and declared prior to the start of the period. Although the specific amount of the interest cannot be determined, the terms of the crediting are unalterably set for the remainder of the current interest-crediting period.

Current Interest Floor Guarantee

During each interest crediting period, whether a single year or a multi-year period, a minimum level of credited interest is guaranteed. Commonly, this is a 0% guaranteed interest rate over a one-year period. For multi-year interest crediting approaches, this is commonly expressed as the greater of 0% and a greater guarantee that is derived from compliance with the SNFLIDA.

Minimum Interest Crediting Guarantee in Later Years

Commonly, the changeable factor in the crediting rate formula has a guarantee of the limiting value that will provide a minimum guaranteed benefit when the crediting formula is declared for the second and later interest crediting periods. This is expressed in terms of a minimum cap or participation rate or a maximum spread fee.

Long-term Interest Floor Guarantee

EIAs not intended to be securities (Note-There have been EIAs within a variable annuity and free-standing registered EIAs) have a cumulative guaranteed floor that complies with the SNFLIDA and guarantee positive contract value increases over the holding period of the contract.

Selection of Interest Crediting Basis

The purchaser of an EIA has very limited interest crediting basis choices. A typical contract offers interest crediting based on only one equity index and, possibly, an alternative for fixed-rate crediting. Some contracts may offer a second or third index alternative. In any case, the index is well defined and broadly used in financial markets; consequently, it provides no opportunity for investment direction by the purchaser other than the broad choice of the index.

Limited Reallocation Flexibility

Some EIA contracts offer a single crediting strategy, e.g., participation rate or capped annual crediting, while others provide several choices of strategies, and may also include fixed-rate crediting. With multiple available strategies, the purchaser generally is allowed to reallocate the contract value among strategies at specified times; however, this flexibility generally is limited to times when the underlying hedges would mature. For contracts with annual ratchet designs, this would allow reallocations only on anniversary dates; for multi-year guarantee designs, this would allow reallocations only at the end of the multi-year guarantee periods. Even when reallocations take place between equity-index-based crediting strategies, this generally is simply a change in interest-crediting strategies and not recognition of a different index.

Control of Assets

The underlying assets for a nonregistered EIA are held in the general account of the insurer. This places them beyond the control and direction of the purchaser.

Method of Selling

EIA contracts are sold in a similar fashion as traditional fixed-rate annuities in that the agent selling the annuity is licensed for insurance sales, provides sales literature that has been prepared by the insurer, and applies the same suitability screening that is used for fixed-rate annuity sales.

<u>Comparison with Fixed-Rate and Variable Annuities</u>

The combination of these characteristics can be compared with both a fixed-rate annuity and a variable annuity in order to better understand the significance of the characteristics.

Comparison with a Fixed-Rate annuity

The characteristics of an EIA, as provided to the purchaser, have much in common with those provided by a fixed-rate annuity.

- The current interest-crediting guarantee conveys value in a manner similar to that in a fixed-rate annuity. The call option value of the interest crediting based on participation in the index within an EIA is comparable to the interest that could have been credited if the contract had a fixed-rate structure. This is apparent in EIAs that include a fixed-rate alternative interest crediting strategy, where the insurer provides comparable value in both the index-based interest crediting and the declared-rate crediting.

- The current interest floor guarantee bears similarity to the current interest crediting guarantee in a fixed-rate annuity, although the level of the guarantee may be lower. The lower guarantee provided to the purchaser is compensated for by the potential for higher actual credited interest when the index-based interest outperforms the fixed rate alternative in the contract.

- The minimum interest crediting guarantee in later years is similar to the minimum interest crediting guarantee in fixed-rate annuities. Although the value of the guarantee may vary when the option-pricing value of the guarantee changes to reflect changing interest and index-volatility circumstances, its core value typically maintains consistency with that offered in a fixed-rate annuity.

- The long-term interest floor guarantee is comparable to that in a fixed-rate annuity because both are designed to comply with SNFLIDA. The requirements of SNFLIDA allow a reduction of up to one percent (per year) in the minimum nonforfeiture interest rate for EIAs, but this is in recognition of the additional risk to the insurer due to the dispersion of actual interest crediting results. The lower guarantee allows the potential for more favorable index-based interest crediting that accrues to the benefit of the purchaser.

- Generally, the selection of interest crediting strategies for an EIA provides a single index as a basis for the interest calculation. This is the same degree of selection as in a fixed-rate annuity. Even when a choice of a fixed-rate allocation is available, it is not adding anything beyond what is commonly offered in an annuity. Choices that include several indices provide limited variations insofar as each index is well defined by an external source.

- Differences among index-based interest crediting strategies are primarily a matter of form rather than substance. Differing strategies will still be rooted in the same hedging cost ("hedge budget") and, consequently, are structured to convey the same inherent value. This is very clear when the interest crediting strategies are based upon the same index, but still is basically true even when the index is different.

- Holding of assets supporting the contract in the general account, and thus beyond the control of the purchaser, is identical to the practice on fixed-rate annuities.

- The requirements and oversight (market conduct review) of the sales process are, as for fixed-rate annuities, regulated by the state insurance departments, generally in accordance with NAIC requirements.

Comparison with a Variable Annuity

The characteristics of an EIA, as recognized by the purchaser, can be compared with those of a variable annuity.

- None of the current, floor, future, or cumulative guarantees is present in a variable annuity, insofar as the essence of a variable annuity is the pass-through structure for the investment returns. Even when a variable annuity contains guaranteed living benefits (GLB), e.g., guaranteed minimum income benefit, guaranteed minimum accumulation benefit, guaranteed minimum withdrawal benefit, or a guaranteed payout annuity floor, the interim cash-out value of the variable annuity prior to the maturity of the GLB has no guarantees. In addition, the risk payoff for a VA is not capped.

- The choices in an EIA of allocations among one or a few equity indices and, possibly, one fixed-rate allocation are very limited, in contrast to a variable annuity in which there may be 40 to 60 choices of subaccounts. The content of the EIA choices is currently limited to the construction of the indices, while the variable annuity subaccounts can take on almost any form.

- The holding of the EIA assets in the general account reflects the obligation of the insurer to credit interest on a guaranteed formula basis, whereas the variable annuity assets are held in separate accounts as a reflection of their pass-through nature.

- EIAs are not required to be sold by registered representatives, although many persons selling EIAs are registered representatives. In this regard, sales requirements for EIAs are similar to those for other fixed annuities.

EIAs from an Insurer's Perspective

EIAs can also be characterized on the basis of the way that the insurer manages the product and its risks. This includes the method of investing to support the product and the resulting financial impact on the insurer.

Product Management Characteristics

Assets that Support EIAs

The typical two-fold composition of the assets that support EIAs is first, an index-based hedge that is structured to cover the index-based interest crediting and, second, fixed-yield assets such as bonds for the balance of the required assets. In the most common EIA structure that credits interest annually, this creates a balance of approximately 3-4% of the assets in hedges and 96-97% in fixed-yield investments. Insofar as it is reasonable for an insurer to invest with the same risk profile for both fixed-yield and equity-indexed products, there can be a 96%+similarity in the investments used for EIAs and fixed-yield products.

Asset-Liability Management (ALM)

The insurer takes on the obligation to deliver the guaranteed benefits, and the resultant responsibility of the insurer is to invest appropriately in order to support the guaranteed benefits. The primary result of this is the purchase of hedges to match the index-based interest liability and the purchase of fixed-yield investments to match the other guarantees. Management of the ALM risk to the company requires modeling and tracking the interest and equity risk exposures.

Risk Profile of Insurer

An insurer that has properly invested for an EIA will typically manage the derivative risk either with static hedging (over-the-counter call options or exchange-traded call options) or dynamic hedging (actively-managed combination of derivative instruments, heavily based on index futures). An insurer that has properly hedged the derivative-based risk will have investment income consisting of payoffs on matured hedging instruments and coupons on fixed-yield investments. The related interest-crediting obligations would then consist of the crediting of interest in an amount comparable to the payoff of the hedge. If actual policyholder persistency matches assumed persistency when the hedge positions were first opened, then the hedge payoff will match the interest credits quite closely with static hedging and will show some variance with dynamic hedging. The coupons on the fixed-yield investments would support the underlying principal guarantees.

This investment risk profile is similar to that with fixed-rate interest guarantees if the index-based interest crediting were for the same amount as if the hedge budget was used for fixed-rate crediting. Even when the index-based interest crediting varies, as it certainly will, the risk is similar because the credited amount is financed by a comparable option payoff. The additional risk to the insurer versus that with a fixed-rate crediting annuity is that the cumulative floor guarantees may incur additional risk in the event of a sequence of low index-based interest crediting terms. This can be mitigated with the lower available minimum nonforfeiture rate for EIAs under SNFLIDA.

Obligations of the Insurer

The insurer is required to provide benefits as guaranteed in the annuity contract. These consist of currently declared crediting guarantees, minimum crediting guarantees in future interest crediting terms, and minimum cumulative contract value guarantees. These obligations are independent of the method in which the underlying funds are invested.

Method of Managing Interest Crediting

Interest is credited on the basis of a series of guaranteed declarations that are made at the beginning of each interest crediting term. In most cases this is annual, but multi-year guarantees are common, too. In the case of annual interest crediting, the insurer typically will broadly translate the interest that would have been credited for fixed-rate crediting into a hedge budget that is applied to the purchase of a call option that matches the index-based crediting that has been guaranteed. In particular, the affordable guarantee is determined as that which can be hedged within the hedge budget. An analogous method is typically used for the determination of index-based interest crediting guarantees in multi-year crediting guarantee annuities.

Profitability Profile

An insurer that effectively manages the ALM risk with the placement of appropriate index-based hedges can anticipate a profitability profile similar to that on a fixed-rate annuity. The tracking will be closest with static hedges and will have some variances with dynamic hedging. The greater dispersion of interest-crediting results on an EIA versus a fixed-rate annuity will broaden the range of potential account values and this will have an impact on profitability, but the mean results should be similar. An aspect of potential reduced profitability is that the cumulative guarantees could come into play with an extended period of low index-based interest crediting. This low-probability event could have a moderate impact on profitability for the issuer of EIAs. The periodic (generally annually) crediting of floored (generally at 0%) interest avoids the cumulative-loss risk problems that exist in VAGLBs. The occurrence of even just a few positive crediting periods either eliminates the loss or greatly mitigates it.

Capital Structure

The regulatory capital requirements for an issuer of EIAs are similar to those for fixed-rate annuities because the risk profiles are similar. The business risk (C-4) and the market value liquidation risk (C-3) requirements are the same as for a fixed-rate annuity, in recognition of the essentially similar risk profiles. The investment risk (C-1) requirement is identical for the fixed-yield investments and is consistently carried forward for the EIA hedging instruments. In the latter case, the capital requirements for static hedging are based on the credit rating of the counterparty, just as for all other investments. If dynamic hedging is used, an insurer may hold additional capital in recognition of the variability of hedging results, but this is compensated for by the lower mean cost of dynamic hedging versus static hedging.

<u>Comparison with Fixed-Rate and Variable Annuities</u>

The comments above generally described the method of managing the EIA risk and the roots of the method, which is based on techniques used for other fixed annuities. The reason for the similarity in product financial management is the similarity of the product to a fixed-rate annuity.

The practices differ in almost all respects from the practices for variable annuities because of the difference in the nature of the risk. An EIA is a product with guarantees that must be supported by the insurer's general account investments, whereas a variable annuity is a pass-through product that transfers the investment risk to the purchaser through a separate account mechanism.

Summary Observations

From a technical perspective we have noted that an EIA provides to a purchaser guarantees and other conditions that are quite similar to those on a fixed-rate annuity. Similarly, the method in which an insurer financially manages the product and realizes financial results is essentially the same as that for a fixed-rate annuity. The combination of these perspectives indicates that nonregistered EIAs operate like fixed-rate annuities and thus have characteristics that support their status as nonregistered products.

Sincerely,

/S:/
Dave Sandberg
VP of Life
American Academy of Actuaries

Cc: Keith Carpenter and William Kotapish