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President

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November 17, 2008

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

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

Dear Ms. Harmon:

Midland National Life Insurance Company and North American Company for Life and Health Insurance (collectively, “Midland” or “we”) are submitting this letter in connection with Proposed Rule 151A under the Securities Act of 1933 (the “Proposed Rule”),¹ pursuant to the re-opened comment period.² The Proposed Rule, if adopted, would operate to exclude certain fixed indexed and other annuity contracts from the exemption provided by Section 3(a)(8) of the Securities Act of 1933, thereby requiring registration of such contracts with the Commission and securities licensing of all salespersons. As noted in the Proposing Release, this proposed rule is “intended to clarify the status under the federal securities laws of indexed annuities, under which payments to the purchaser are dependent on the performance of a securities index.”³

This letter supplements an earlier letter submitted by Midland to make three points:

- (1) The recent drop in stock prices demonstrates that under fixed indexed annuities, it is the insurance company, not the policy owner, who bears the market investment risk;
- (2) The recent collapse of financial giants shows that insurance companies bear substantial counterparty investment risk; and
- (3) In discussing an important judicial precedent, certain comments submitted by others overlook and omit a critical factual and legal issue and therefore misconstrue precedent.

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

² See Rel. Nos. 33-8976 and 34-58769 (Oct. 10, 2008).

³ Release at 1.

Background

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

Midland supports the Commission's ongoing efforts to enhance consumer protection and its efforts to provide greater certainty to issuers and sellers of annuity products, including fixed indexed annuities, with respect to their obligations under the federal securities laws. Midland believes strongly that there is no place for inappropriate sales practices involving fixed indexed or other fixed annuities, just as with other investment or insurance products and services.

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

Section 3(a)(8) exempts from the registration provisions of the 1933 Act any annuity contract (or optional annuity contract) issued by an insurance company subject to the supervision of a state insurance commissioner (or similar entity or official).⁵ In determining whether a particular insurance product is exempt under Section 3(a)(8), courts and the Commission have historically focused on three key factors in relation to the product: (1) the allocation of investment risk between the insurer and the contract owner; (2) the manner in which the product is marketed, *i.e.*, whether the product is being promoted primarily as insurance or primarily as an investment; and (3) whether the insurer assumes a meaningful mortality risk.

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

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

⁵ In fact, the Supreme Court, the Commission, and commentators view Section 3(a)(8) as an exclusion from all provisions of the 1933 Act. See Tcherepnin v. Knight, 389 U.S. 332, 342-43 n.30 (1967) (dictum) ("the exemption from registration for insurance policies was clearly supererogation"); Berent v. Kemper, 780 F. Supp. 431, 440-41 (E.D. Mich. 1991) ("insurance policies that come within Section 3(a)(8) are excluded from the anti-fraud provisions of all federal securities laws"); Definition of Annuity Contract or Option Annuity Contract, Securities Act Release No. 6558, [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,710 at 87,160 (Nov. 21, 1984); L. Loss, Fundamentals of Securities Regulation 204 (1988).

1. The Recent Massive Drop In Stock Prices Demonstrates That Under Fixed Indexed Annuities, It Is The Insurance Company, Not The Policy Owner, Who Bears The Market Investment Risk

According to Congress, over \$2 trillion of retirement savings has been lost over the last 15 months due to the market downturn. Investors in mutual funds and variable annuities have seen their retirement nest eggs drop in value in amounts of 20%, 40%, 50%, or more. They bore the investment risk by directing their savings into securities.⁶

At the same time, owners of typical fixed indexed annuities, and certainly all owners of Midland fixed indexed annuities, lost nothing as a result of the market downturn. The account value of their contracts has not declined. They may be credited with little or no interest for this period, but their principal is safe. They do not bear the risk of a decline in the value of their annuity.

As discussed in Part III of Midland's prior comment letter,⁷ in the *VALIC* and *United Benefit* cases, the Supreme Court addressed variable annuities, where the purchaser bore the investment risk of a decline in value of the pool of securities. However, purchasers of fixed indexed annuities are in an entirely different situation – the value of their principal is guaranteed against investment loss by the insurer. The insurance company issuing fixed indexed annuities bears significant investment risk in providing that guarantee. In *VALIC* and *United Benefit*, by contrast, the insurance companies provided no such guarantee that is meaningful.⁸ The risk of loss of principal at issue in those cases is not present with fixed indexed annuities, and the recent market downturn has clearly demonstrated the importance of the guarantees in fixed indexed annuities.

In the Release, the Commission asserts that purchasers of fixed 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.” Recent market events demonstrate how wrong that assertion is. Those who were invested in mutual funds and variable annuities assumed the market investment risk, and unfortunately they have suffered tremendous losses of principal as a result. Those who were invested in fixed indexed annuities during this period did not assume the market investment risk, and they have not lost a penny of their principal due to the downturn in the market. This shows why fixed indexed annuities are entitled to rely on the Section 3(a)(8) exemption while variable annuities, like those involved in *VALIC* and *United Benefit*, are not.

⁶ It is ironic, and sad, that the Commission tries to justify its proposal by arguing that it is intended to protect investors. Federal regulation and registration under the securities laws did not protect investors from those massive losses.

⁷ See letter dated September 10, 2008, from Esfandiyar Dinshaw, President, Sammons Annuity Group, in SEC File No. S7-14-08.

⁸ The Supreme Court characterized *United Benefit's* minimum guarantee as “insignificant.”

2. The Recent Collapse of Financial Giants Shows That Insurance Companies Bear Substantial Counterparty Investment Risk

Insurance companies that issue fixed indexed annuities generally attempt to manage the investment risk they bear in two ways. First, they invest in various types of debt securities to support or fund the guarantee of principal and any guaranteed interest.⁹ Second, they may invest in options, futures, or other types of sophisticated investments to hedge the indexed interest obligation.

With respect to both types of investment activities, insurers assume investment risk beyond the risk that the market value of the investments will decline and not be sufficient to support the fixed indexed annuity guarantees. In both cases, there is a “counterparty” to the investment. For investment in debt, the counterparty is the entity that issued the debt instrument. For options and other sophisticated investments, it is the party that sold the option or entered into the contract with the insurer. In both cases, the insurance company bears the risk that the counterparty will fail or otherwise be unable to fulfill its obligation.

Because of this counterparty investment risk, insurers generally only deal or contract with counterparties that are believed to be financially strong (*i.e.*, they have very high ratings from ratings agencies), where the insurance company is confident that they will be around when the time comes and be able to fulfill their obligations. However, recently several “financial giants” that were among the biggest financial institutions in the country (or world), who were very highly rated, and generally believed to be financially strong, have collapsed or experienced severe financial difficulties in a very short period. With respect to fixed indexed annuities, it is the insurance company that bears this counterparty investment risk, which recent events have shown is a real and substantial risk. With respect to mutual funds and variable annuities, however, it is the individual investor in the product that indirectly bears this risk.

The bearing of counterparty investment risk is an important factor under Section 3(a)(8) and further demonstrates that fixed indexed annuities are indeed annuities under that statute.

3. Judicial Precedent Does Not Require That The *Rate* Of Any Excess Indexed Interest Be Determined In Advance

At least one comment letter seems to argue that judicial precedent requires that the rate of any excess indexed interest must be declared in advance in order to rely on Section 3(a)(8).¹⁰ However, the letter’s discussion of the one case cited to support that proposition overlooks and omits a critical factual issue.

⁹ In addition to principal, any indexed interest is generally guaranteed once it is credited to the contract. In addition, the issuer guarantees to pay excess indexed interest according to the formula set out in the contract, regardless of the performance of its own investments.

¹⁰ See letter from Ms. Diane Ambler, K&L/Gates, dated October 7, 2008, on behalf of five named insurance companies, in SEC File No. S7-14-08.

In discussing *Associates in Adolescent Psychiatry v. Home Life Ins. Co.*,¹¹ the letter states that the court determined that the annuity at issue was not a security because the purchaser had certainty as to amounts of interest and excess interest that would be paid for the specified period (*i.e.*, the total interest rate, including the amount of excess interest, was declared in advance), and the court contrasted this with the instruments at issue in *VALIC* and *United Benefit*, where the amount was determined retroactively.¹² The letter then states that “it is generally decisive that the guarantees be identified prospectively – which is typically not true of equity indexed annuities.”

That statement is incorrect, because it overlooks a crucial distinction and confuses two separate matters. In fixed indexed annuities, **the guarantees** are indeed typically identified prospectively. This includes the specification of the index, the crediting method, participation rates, caps, and spreads. While the insurer generally may reserve the right to change these factors in the future, they are generally guaranteed *in advance* at the beginning of each crediting period. Using these guaranteed factors, the **interest rate** is determined at the end of the crediting period.

The distinction between the guarantees and the interest rate is critical to evaluating the bearing of investment risk. In *Home Life*, the insurer did announce the annual interest rate in advance, at the beginning of each policy year. Nevertheless, the court stated that the insurer “did not assume a great deal of risk by guaranteeing an annual rate of return in advance: the declared rate was based on the performance of Home Life’s portfolio over the last year, and only about 6% of the value of the portfolio was reinvested annually.”¹³ Since Home Life had the *discretion* to declare a rate that reflected its actual earnings, it could keep its risk low.

However, issuers of fixed indexed annuities do not have that discretion. The rate, although calculated at the end of the period, is determined exclusively by the factors that are guaranteed at the beginning of the period. The insurer has no discretion to declare a rate that reflects its actual earnings –it must pay whatever rate is calculated according to the terms of the contract, regardless of its actual earnings, so it bears the substantial investment risk that its actual earnings will fall short. Since issuers of fixed indexed annuities guarantee the method and factors for determining the interest rate in advance at the beginning of each period, and do not have the discretion to declare a rate that reflects their actual earnings, under *Home Life* they bear an even greater investment risk than issuers of traditional fixed interest annuities that declare a rate in advance, at their discretion. Accordingly, the distinction between declaring the actual **rate** retroactively at the issuer’s discretion, and declaring the indexed interest **guaranteed factors** in advance while calculating the rate at the end of the period (with no discretion), is crucial to evaluating the investment risk borne by the issuer. While it may be important for a **discretionary** rate to be declared in advance, it simply does not follow that it is important for an **indexed** rate to

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

¹² The *Home Life* court incorrectly described this amount as “interest,” but it was actually a “pass-through” of the earnings (or loss) of the pool of securities.

¹³ 941 F.2d at 567. The court held that the contract did not place excessive risk on the purchaser and consequently was an annuity.

be determined in advance. *Home Life* does not support the proposition that fixed indexed annuities are securities simply because the actual rate of indexed interest is calculated at the end of the period.

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Thank you for your consideration of these comments.

Sincerely,



Esfandiyar E. Dinshaw
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Midland National Life Insurance Company
North American Company for Life and Health Insurance