JAMES P. PAYNE
SENIOR VICE PRESIDENT–SECRETARY

November 17, 2008

VIA E-MAIL

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

Re: Supplemental Comments on Proposed Rule 151A
Indexed Annuities and Certain Other Insurance Contracts
<u>File Number S7-14-08, Release Nos. 33-8933, 34-58022</u>

Dear Ms. Harmon:

National Western Life Insurance Company (the "Company", "National Western" or "we"), a significant writer of indexed annuity contracts in the United States,[1] appreciates the opportunity to supplement its prior comments in response to the request by the Securities and Exchange Commission ("Commission" or "SEC") in Release No. 33-8933 (the "Proposing Release")[2] for comments on proposed rule 151A. As noted in the Proposing Release, proposed Rule 151A would deem certain annuity contracts for state law purposes as not an "annuity contract" or "optional annuity contract" under Section 3(a)(8) of the Securities Act of 1933 (the "1933 Act"). National Western previously submitted a letter to the Commission commenting on proposed Rule 151A on September 10, 2008.[3]

National Western reiterates its staunch support for strong and effective regulation of disclosure, suitability and sales practice standards for fixed indexed annuity contracts. National Western maintains that a regulatory framework that embodies robust customer protections is vital to the protection of purchasers of fixed indexed annuity contracts and is in the best interests of all concerned parties, including writers of fixed indexed annuity contracts. National Western continues to believe, however, that those customer protection goals have been and continue to be most effectively met through the regulation of fixed indexed annuity contracts by the insurance department of each state, not through duplicative, unnecessary and expensive regulation by the

---

[1] National Western is a publicly-held insurance company domiciled in the State of Colorado that, as of December 31, 2007, had approximately $7 billion in assets.

[2] See Indexed Annuities and Certain Other Insurance Contracts, Rel. Nos. 33-8933, 34-58022 (June 25, 2008). The Commission reopened the comment period until November 17, 2008 in Release 33-8976 (Oct. 10, 2008).

[3] Letter from James P. Payne, Senior Vice President – Secretary, National Western Life Insurance Company, to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, dated September 10, 2008 ("September Letter").

850 EAST ANDERSON LANE • AUSTIN, TEXAS 78752-1602
TEL. 512-719-2362 • FAX 512-719-8503 • WATS 800-531-5442
EMAIL: jpayne@nationalwesternlife.com

SEC and the Financial Industry Regulatory Authority ("FINRA") that proposed rule 151A would require.

As noted in our September Letter, National Western believes that proposed rule 151A is fundamentally flawed and strongly opposes adoption of the rule by the SEC. In National Western's view, proposed rule 151A is an unworkable, ill-conceived rule that is arbitrary, capricious and inconsistent with Congressional intent to preserve for the states the regulation of insurance that is embodied in Section 3(a)(8) of the 1933 Act. Proposed rule 151A is also fundamentally in conflict with and not supported by judicial precedent and prior SEC interpretations. National Western also opposes proposed rule 151A on the grounds that the proposed rule would impose high unnecessary costs on both purchasers of fixed indexed annuity contracts and insurance company writers of fixed indexed annuity contracts, some of which the SEC and its staff have failed to identify or fully account for in the Proposing Release.

In this supplemental letter, National Western would like to take the opportunity to express its disagreement with the positions taken and statements made by some industry supporters of proposed rule 151A. National Western believes that those commenters have introduced into the public record a number of statements that are either factually or legally incorrect and that should be corrected to ensure the SEC can make a properly informed decision regarding proposed rule 151A.

National Western is concerned that certain comment letters have mischaracterized fixed indexed annuity contracts by representing or implying that the contracts allow for "participation in" the financial markets. Apparently, those commenters either do not understand, or refuse to acknowledge, that fixed indexed annuity contracts do not pass-through financial market performance and they have failed to consider the substantial guarantees provided by fixed indexed annuity writers under the contracts. Their analysis and conclusions have distorted the fundamental structure of fixed indexed annuity contracts, which are conservative retirement savings vehicles. These comment letters ignored data that indicates contract owners purchase fixed indexed annuity contracts for stability and security, in particular for the preservation of principal in declining financial markets, such as the current market cycle. National Western also believes that some supporters of proposed rule 151A have largely disregarded the steps taken by fixed indexed annuity writers to ensure their contracts are not marketed as securities in accordance with standards established by the Supreme Court and other federal courts and prior SEC interpretations.

Lastly, National Western would like to reaffirm its support for state regulation of indexed annuity contracts. It is National Western's view that some supporters of proposed rule 151A have failed to appreciate the value of state insurance regulation for consumers, have largely discounted the breadth and depth of state regulation of fixed indexed annuity contracts and have exaggerated the abuses associated with these products. On the other hand, the recent demise or reorganization of large commercial and investment banks, the continuing crisis in the financial markets and the necessary fallout from these events call into question the resources that the SEC would be able to dedicate to regulating fixed indexed annuity contracts – contracts that the SEC and its staff have had very little, if any, experience regulating. This contrasts markedly with the

stability and viability of the life insurance industry and the history of state insurance department regulation of fixed indexed annuity contracts.

I. The Argument that Fixed Indexed Annuity Contracts Should Be Regulated as Securities Because They Allow Participation in the Performance of the Financial Markets Is Inconsistent With the Operation of the Contracts and the Assumption of Substantial Investment Risk By Fixed Indexed Annuity Writers.

In a letter submitted on behalf of AXA Equitable Life Insurance Company, The Hartford Financial Services Group, Inc., MassMutual Financial Group, Metropolitan Life Insurance Company and New York Life Insurance Company, the author equated ownership of fixed indexed annuity contracts with participation in the equity markets noting that: "Unlike traditional fixed annuities, equity indexed annuities include as a *basic defining component* an opportunity for the owner to participate in the performance of the equity markets by application of a contractually defined formula."[4] Likewise, in a letter submitted by the North American Securities Administration Association ("NASAA"), the NASAA, quoting from a study by a private consulting firm that specializes in plaintiff class action litigation, asserted that "[t]he investment risks [of fixed indexed annuity contracts] to which investors are exposed are virtually identical to the risks of investing in mutual funds and variable annuities."[5]

These statements in the AXA Letter and the NASAA Letter are wrong and misleading in refusing to recognize that purchasers of fixed indexed annuity contracts are risk-averse, purchasing the contracts for security and preservation of principal and that such purchasers are unwilling to assume the risk of loss of principal by investment in the equity markets. The Letters also suggest that the authors simply do not understand the basic structure of fixed indexed annuity contracts. Fixed indexed annuities <u>do not</u> pass-through the investment performance of investments in the equity markets as do variable annuity contracts and mutual funds; rather, they provide substantial guarantees of principal and interest. The Letters fail to address in any meaningful way the substantial investment risk assumed by the writers of fixed indexed annuity contracts through the substantial guarantees of principal and interest under the contracts. Rather

---

[4] Letter from Diane E. Ambler, Esq., Kirkpatrick & Lochart Preston Gates Ellis LLP, on behalf of AXA Equitable Life Insurance Company, The Hartford Financial Services Group, Inc., MassMutual Financial Group, Metropolitan Life Insurance Company and New York Life Insurance Company, to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, dated October 7, 2008 ("AXA Letter") at 1.

[5] Letter from Karen Tyler, NASAA President and North Dakota Securities Commissioner, to Florence Harmon, Acting Secretary, Securities and Exchange Commission, dated September 10, 2008 ("NASAA Letter") at 3, citing <u>An Economic Analysis of Equity-Indexed Annuities</u>, by Craig J. McCann, PhD, CFA, Securities Litigation & Consulting Group, Inc. (Sept. 10, 2008) ("McCann Report").

In National Western's view the assumptions and conclusions in the McCann Report are biased and otherwise suspect, and in the very brief period since the publication of the McCann Report, have been questioned and refuted by at least one well-known and respected authority on fixed indexed annuity contracts. <u>See generally</u> Ibbotson Associates/IFID Centre Conference: Guaranteed Living Income Benefit Insurance Products, <u>Un-Supermodels and the FIA</u>, David F. Babbel, Professor of Insurance and Finance, The Wharton School of Business, University of Pennsylvania (Nov. 11, 2008).

than participating in the equity markets on a daily basis, as do mutual funds and variable annuities, fixed indexed annuities typically refer to an external index for purposes of determining and crediting interest no more frequently than once a year.[6] The investment risk of a fixed indexed annuity contract is not only different from the investment risk of mutual funds and variable annuity contracts; it is predominately borne by the insurance company writer of the contract.

Fixed indexed annuity contracts are clearly distinguishable from the contracts whose status was in question in S.E.C. v. Variable Annuity Life Ins. Co. ("VALIC")[7] and S.E.C. v. United Benefit Life Ins. Co. ("United Benefit"),[8] precisely because of the absence of any pass-through of investment performance. It is well-recognized that the variable annuity contracts in both VALIC and United Benefit essentially passed-through on a daily basis the full investment risk of the investments in the insurer's general or separate account to the contract owner, and that fixed indexed annuity contracts simply do not.

Fixed indexed annuity contracts are fixed annuity contracts in their purest form because they provide guaranteed minimum values that equal or exceed the requirements of applicable state non-forfeiture law; they credit only positive rates of indexed interest and at most once a year; and they guarantee all of the indexed interest previously credited. Under National Western's fixed indexed annuity contracts, a contract owner's principal and previously credited interest are guaranteed and can not be diminished by any negative performance of the external equity index. This is in direct contrast to a variable annuity contract or a mutual fund under which a contract owner's or investor's principal is at risk and is subject to a full pass-through of the investment experience of the underlying portfolio securities, whether positive or negative. A recent New York Times article explained in clear terms the difference between a fixed index annuity contract and a mutual fund, noting that:

> The index annuity, which started with $100,000 in October 1998, would have had an account value of $176,478 as of Friday's [October 24, 2008] market close. The S.& P. 500 index fund, which also started with $100,000, would have actually lost money over 10 years, ending with a balance of $81,890. [9]

Unlike a variable annuity contract, payments under fixed indexed annuity contracts are also not priced based on the performance of specified investments and there is no pooling of

---

6 The one-year limit on crediting indexed interest is important since it limits any change (i.e., volatility) to an annual change in the interest rate – the same rate of volatility that the SEC found acceptable for fixed annuities that meet the safe harbor rule 151 under Section 3(a)(8).

7 S.E.C. v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959).

8 S.E.C. v. United Benefit Life Ins. Co., 387 U.S. 202 (1967).

9 Ron Lieber, "Your Money: Weighing an Investment That Promises No Risk," The New York Times (Oct. 25, 2008).

investment risks among contract owners through a variable separate account. Fixed indexed annuities, by contract, provide significant guarantees of principal and previously credited interest, placing substantial investment risk squarely on the writers of fixed indexed annuity contracts.

Both VALIC and United Benefit, the only Supreme Court cases to consider the status of annuity contracts under Section 3(a)(8), require that the investment risk borne by the insurance company under a fixed annuity contract be taken into account in determining the status of the contract as a security. In VALIC, the Court noted that ". . .we conclude that the concept of 'insurance' involves some investment risk-taking on the part of the company"[10] and that ". . . the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense."[11] From the Court's statements, it is clear that guarantees of principal and interest are critical to its determination of whether an insurance company that underwrites an annuity contract can rely on the Section 3(a)(8) exemption under the 1933 Act.

Neither VALIC nor United Benefit, however, held or suggested in any way that an insurer whose contract provides sufficient contractual guarantees of principal and interest is not entitled to reliance on the Section 3(a)(8) exemption. National Western's fixed indexed annuity contracts are fundamentally distinct from the contracts in VALIC and United Benefit precisely because of the strength of their contractual guarantees of principal and interest as required by state nonforfeiture law and guarantees of previously credited interest.

II. Supporters of the "More Likely Than Not" Risk Test in Proposed Rule 151A Are Legally Wrong in Focusing Solely on the Likelihood of "Excess" Indexed Interest.

The NASAA and the Investment Company Institute ("ICI"), along with other commenters, have endorsed proposed rule 151A and its two-prong test for determining whether a fixed indexed annuity contract should be subject to registration as a security – the "more likely than not" test.[12] Not surprisingly, both the NASAA and the ICI endorsed proposed rule 151A and the "more likely than not" test without providing any legal analysis of how the proposed test comports with well-established judicial and SEC interpretations of Section 3(a)(8).

As noted in our September Letter, the "more likely than not" test under proposed rule 151A focuses exclusively upon the likelihood of "excess" indexed interest being paid and does not permit consideration of the risk of loss to the contract owner. Nor does the proposed test take into account the significant guarantees provided by insurance companies that write fixed indexed annuity contracts, including guarantees of principal, minimum levels of interest,

---

10 VALIC, 359 U.S. at 71.

11 Id.

12 See generally NASAA Letter; Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Ms. Florence Harmon, Acting Secretary, U.S. Securities and Exchange Commission, dated September 10, 2008 ("ICI Letter").

previously credited interest, credited interest based on the performance of an index and terms of the contract, a death benefit and annuity purchase rates. This singular focus on the likelihood of the payment of excess interest to contract owners is inconsistent with precedent under Section 3(a)(8). Judicial interpretations of Section 3(a)(8) require an evaluation of not only the risk of loss borne by the contract owner, but also a weighing of the investment risk borne by the contract owner against the investment risk borne by the insurance company.[13]

The singular focus of the "more likely than not" test is also inconsistent with the more general facts and circumstances test for analyzing investment risk in determining the availability of the Section 3(a)(8) exemption that historically has been followed by the SEC. In its release proposing rule 151, the current safe harbor rule for annuity and optional annuity contracts, the SEC itself acknowledged that the test for assessing the availability of the Section 3(a)(8) exemption must involve a facts and circumstances analysis of how investment risk is shared among the insurance company and the contract owner.[14]

As discussed in greater detail in our September Letter, the "more likely than not" test is also fundamentally flawed in at least two very important respects. First, the test lacks any semblance of proportionality.[15] There is no weighing of the risk of loss of an amount of excess interest against the amounts of contractually guaranteed interest and principal under the test. If indexed interest were presumed to be credited more than half of the time under a contract, no matter how small the amount, the fixed indexed annuity contract would be a security under the test.

Second, the treatment of surrender charges under the "more likely than not" test skews the test in such a way so as to assure that any fixed indexed annuity contract with a surrender charge must register as a security, thus eliminating the Section 3(a)(8) exemption for those

---

[13] See, e.g., VALIC, 359 U.S. at 71 ("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"); Olpin v. Ideal Nat'l Ins. Co., 419 F.2d 1250, 1262 (10th Cir. 1969) (insurer bore sufficient investment risk when it was obligated to pay an amount that could be mathematically calculated, and given the insurer's unconditional obligation to pay). See also the SEC's Amicus Brief filed in the case of Otto v. Variable Annuity Life Insurance Co., 814 F.2d 1127 (7th Cir. 1986), rev'd on rehearing, 814 F.2d 1140 (1987), modified (1987), cert. denied, 486 U.S. 1026 (1988) in which the SEC argued that an annuity qualified for Section 3(a)(8) if "the insurance company assumes a sufficient share of the investment risk, which reduces the risk to the participant, who is also protected by state regulation of the insurance company. Even though the participant bears some degree of risk, the contract may qualify under the 'annuity contract' exemption." Brief for the United States as Amicus Curiae, Variable Life Annuity Insurance Co. v. Otto, 486 U.S. 1026 (May 23, 1988) (denying certiorari) at 7.

[14] See Definition of Annuity Contract or Option Annuity Contract, Rel. 33-6558 [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,710 at 87,160 (Nov. 21, 1984) at 2. In explaining the necessity of assessing investment risk under a facts and circumstances analysis for any fixed annuity contract, the SEC noted that: "Determining the status under the [1933] Act of any [fixed annuity] contract involves certain factual and legal questions, *e.g.*, whether the insurer or the contractowner is assuming the investment risk under the contract. . . . Since under a guaranteed investment contract the insurer and the contractowner may *share* the investment risk to varying degrees, depending on the facts and circumstances involved, this type of contract cannot always readily be characterized either as "insurance" or as a "security" for purposes of section 3(a)(8)."

[15] September Letter at 9.

products.[16] Under paragraph (b)(1) of proposed rule 151A, an insurance company can not take surrender charges into account in determining amounts payable under a fixed index annuity contract, but must take surrender charges into account in determining amounts guaranteed under the contract. In addition, as discussed in our September Letter, the incorporation of surrender charges into an investment risk analysis under Section 3(a)(8) is not only unprecedented, it is completely contrary to the SEC's own treatment of surrender charges in any Section 3(a)(8) analysis.[17]

The SEC in proposing the "more likely than not" test and commenters in endorsing the test have essentially redefined investment risk in the context of evaluating the security status of fixed indexed annuity contracts to mean only the volatility of the positive, annually-credited interest rate. Such a myopic definition of investment risk is unsupported by well-established judicial and prior SEC interpretations of Section 3(a)(8) and completely ignores a fundamental aspect of investment risk recognized by the Supreme Court in VALIC and United Benefit – the risk of loss of principal. In neither case did the Supreme Court identify volatility of the positive, annual interest rate as an aspect of investment risk, much less the sole defining characteristic of investment risk. Nor can the SEC point to any SEC releases interpreting Section 3(a)(8) that defines investment risk solely as the volatility of the annual, positive interest rate.

The failure of supporters of Rule 151A to reasonably explain the place of the "more likely than not" test within the body of Section 3(a)(8) precedents is, we believe, not due to lack of trying, but rather is evidence of the wholly unprecedented, unsupportable nature of the "more likely than not" test.

III. Assertions That Fixed Indexed Annuity Contracts Are Sold Based on the Promise of Participation in Financial Market Performance Mischaracterize the Marketing of Fixed Indexed Annuity Contracts By Insurers and Misconstrue the Marketing Test under Section 3(a)(8).

The AXA, ICI and NASAA Letters and others supporting proposed rule 151A have focused on the indexed interest crediting feature, and have drawn from the mere existence of that feature the conclusion that writers of those contracts must market the contracts primarily as investments, not insurance products. For example, the ICI Letter notes that ". . . it can be difficult to fairly market certain indexed annuities as other than securities."[18] The ICI Letter goes on to state that "Those marketing such annuities recognize that they are designed for investors seeking to achieve the 'upside' potential returns of the stock and other securities markets without the 'downside' risk that ordinarily accompanies those investments. Thus, a fair

16 Id.

17 Id. at 10.

18 ICI Letter at 3.

explanation of these indexed annuities requires communication about the stock and bond securities markets."[19]

Comparable statements can be found in the AXA and NASAA Letters. The AXA Letter, for instance, opines that "This potential to participate in prospective market performance is critical to the sale of equity indexed annuities – investors buy these products because of the opportunity to participate in the market . . ."[20] The NASAA Letter, even before the start of any substantive discussion of the marketing of fixed indexed annuity contracts, concludes that "Finally, EIAs are marketed primarily as investments, not as insurance products."[21]

The Letters, however, fail to recognize that fixed indexed annuity contracts appeal to purchasers who are risk-averse and want security and peace of mind. The AXA and ICI Letters also fail to recognize a very well-established body of judicial precedent that articulates standards for marketing fixed insurance contracts within the bounds of the Section 3(a)(8) exemption. The Letters simply do not consider that companies have developed marketing programs and sales practices for fixed indexed annuity contracts that comply with those standards.

The NASAA Letter, on the other hand, simply misconstrues the judicial precedent on marketing fixed insurance contracts in conformity with the Section 3(a)(8) exemption. The NASAA incorrectly suggests that the mere mention of the investment aspects of a fixed indexed annuity contract would be sufficient to conclude that the contract is marketed primarily as a security and therefore must fall outside the Section 3(a)(8) exemption.[22] The NASAA's position is inconsistent with both judicial and SEC interpretations of the marketing component of a Section 3(a)(8) analysis. The NASAA Letter also misleads by identifying isolated instances of inappropriate marketing practices and suggests that those practices are representative of the entire fixed indexed annuity industry.[23]

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 promoted and 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."[24] 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

---

19 Id.

20 AXA Letter at 2.

21 NASAA Letter at 5.

22 Id. at 12, 13.

23 Id. at 13 ff. (Citing examples from FINRA NTM 05-50 of statements included in promotional materials that tout the investment aspects of fixed indexed annuity contracts.)

24 United Benefit at 211.

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.[25] 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."[26]

The SEC 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 SEC 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."[27]

Fixed indexed annuity writers control the content of their marketing materials to comport with these standards; moreover, these standards are applicable to the advertising of fixed indexed annuity contracts under various state insurance laws. By not considering judicial precedent and

---

25 729 F. Supp 1162 (N.D. Ill., 1989); aff'd, 941 F.2d 561 (7th Cir. 1991), cert denied, 502 U.S. 1099 (1992).

26 Id. at 1174 (emphasis added).

27 See Definition of Annuity Contracts or Optional Annuity Contracts, Rel. No. 33-6645 (May 29, 1986) at 13 (emphasis added).

prior SEC interpretations that articulate standards to assess whether the marketing of fixed insurance contracts meets the requirements of Section 3(a)(8), and by ignoring the efforts undertaken by insurers to ensure that their fixed indexed annuity contracts are marketed in a manner that comports with such standards, the AXA and the ICI Letters fail to provide a complete and fair analysis of whether fixed indexed annuity contracts should be regulated as securities.

The NASAA Letter also fails to provide a complete and fair analysis of whether fixed indexed annuity contracts should be regulated as securities, but for other reasons. In particular, the NASAA evaluates the marketing of fixed indexed annuity contracts in a manner wholly inconsistent with relevant judicial precedent and SEC interpretations and attempts to characterize the marketing programs for all fixed indexed annuity writers through references to isolated incidences of questionable marketing practices. For the reasons noted, National Western finds the conclusory statements in the AXA, ICI and NASAA Letters regarding the marketing of fixed indexed annuity contracts to be wholly without merit.

The AXA, ICI and NASAA Letters also assert that owners of fixed indexed annuity contracts are urged to purchase these contracts primarily, if not exclusively, for the promise of future participation in the investment performance of the financial markets. Those statements are wholly unsupported and inconsistent with historical practice. Instead, fixed indexed annuity contracts are purchased by owners who desire to preserve principal and to receive the guarantees of interest and previously credited interest under the contracts. They are a "safe money" product purchased by risk-averse owners who desire safety and security. Statements made by applicants in applying for National Western's fixed indexed annuity contracts support this conclusion.

The history of fixed indexed annuity contract sales also demonstrates that sales of the contracts tend to increase when financial markets are in decline. The data show that sales of fixed indexed annuity contracts increase during times when consumers are looking for safety and security through the guarantees of principal and interest provided by indexed contracts. If a National Western fixed indexed annuity contract were purchased and held through the surrender charge period, assuming no withdrawals were made, then the principal would not decline and contract value would increase regardless of the investment performance of the external index and the financial markets. (See Appendix A for a chart comparing the return of the S&P 500 index and the return of a typical National Western fixed indexed annuity contract between 1998 and 2008.) The same cannot be said for an investment in a variable annuity contract or mutual fund.

IV. Arguments by Supporters of Proposed Rule 151A That There Is a Need for Federal Regulation of Fixed Indexed Annuities Are Wrong and Not Persuasive.

Federal Interest. One argument that has been put forth by some supporters of registration of fixed indexed annuity contracts is that state insurance regulation has been ineffective in halting rampant sales practice abuses in the sale of fixed indexed annuity contracts

and therefore consumers need the protections of the federal securities laws. The ICI notes in its Letter that ". . . both the Commission and FINRA have recognized, indexed annuities are complex products with a history of sales practice abuses."[28] In support of its statement, the ICI Letter cites page 8 of the Proposing Release. However, neither page 8 of the Proposing Release nor the rest of the Proposing Release provides any empirical evidence to support the statement. With respect to the ICI's assertion that fixed indexed annuity contracts are complex products, what the ICI either fails to realize or refuses to admit is that whether or not a "product" is complex is not a justification to regulate it as a security. Insurance by its very nature is complex, but Congress, through the enactment of Section 3(a)(8), has deemed insurance products to not be securities.

The NASAA Letter also alleges widespread sales practice abuses in the sale of fixed indexed annuity contracts. In particular, the NASAA Letter notes that "The sales abuses associated with EIAs have been thoroughly documented over the years in regulatory warnings, governmental enforcement actions, private lawsuits, and media accounts, including the recent investigation featured on "Dateline NBC. . . . Statistics compiled by the NASAA indicate that variable or equity-indexed annuities were involved in a third of all cases in which senior citizens were subjected to securities fraud or abuse."[29] The NASAA, however, cites only a few isolated enforcement cases and provides anecdotal evidence in its letter to support its allegation. It is interesting, however, that the NASAA does not attempt to explain why variable annuity contracts, which are registered with the SEC and whose sales are regulated by FINRA, would also figure so prominently in the securities fraud cases involving seniors based on statistics compiled by the NASAA. Clearly SEC registration and FINRA regulation are no panacea for sales abuse.[30]

The statistics compiled by the NASAA of securities fraud and other abuses involving seniors also appears to report the information in the aggregate, not separately for fixed indexed annuity contracts, and would therefore preclude any meaningful analysis of that information by the SEC and the public. Moreover, despite repeated requests, the NASAA has not made the source data behind those statistics available to the public, other regulators or the SEC for review and analysis. Indeed, neither the SEC in the Proposing Release, the ICI nor NASAA in their Letters nor any other supporters of proposed rule 151A have provided any empirical evidence of widespread sales practice or other abuses involving fixed indexed annuity contracts that would demonstrate a failure on the part of state insurance departments to regulate sales of the contracts so as to implicate a federal interest in providing consumers with the protections of the federal securities laws.

---

[28] ICI Letter at 3, 4.

[29] NASAA Letter at 2.

[30] In her testimony before the U.S. Senate Special Committee on Aging on March 29, 2006, Patricia D. Struck, President of NASAA, confirmed that federal regulation of <u>variable annuity contracts</u> was unable to prevent unsuitable sales of the contracts noting that "A perennial fixture on NASAA's annual list of top scams involve the sale of variable annuities to investors with little regard to whether or not the product is suitable."

Consumer Protection. Supporters of proposed rule 151A have significantly underestimated the scope and breadth of state insurance department regulation of fixed indexed annuity contracts and have argued that state insurance department regulation focuses primarily upon the solvency of insurance companies, not consumer protection. In its Letter, the NASAA states "With respect to enforcement philosophy, insurance regulation has never been marked by a particularly aggressive, pro-consumer approach. In general, insurance departments have focused their resources on overseeing the solvency of insurance companies. This function, vital though it may be, offers little protection against the abusive sales practices that our nation's investors routinely face."[31]

The NASAA, however, fails to give adequate credit to the protections afforded consumers under state insurance department regulation and to acknowledge that state insurance departments are equally committed to consumer protection as they are to solvency regulation.[32] As we noted in our September Letter, state insurance departments have regulated fixed indexed annuity contracts since their inception, more than 13 years ago, and together with the National Association of Insurance Commissioners ("NAIC"), have developed and are continually enhancing disclosure, suitability and sales practice standards for fixed indexed annuity contracts.

Over 30 states have adopted NAIC model regulations that address suitability and disclosure requirements, including the Suitability in Annuity Transactions Model Regulation. Nearly every state has adopted the NAIC Life Insurance and Annuities Replacement Model Regulation or similar regulations that regulate the activities of insurance companies and agents in the replacement of existing life insurance and annuity contracts. In addition, the NAIC's Annuity Disclosure Model Regulation or comparable regulations have been adopted in 22 states and are complied with on a 50-state basis by many fixed indexed annuity writers.

Each of the NAIC's and state insurance department initiatives noted above, National Western's own response to those initiatives, as well as other measures National Western has undertaken to ensure the protection of purchasers of its fixed indexed annuity contracts are discussed in greater detail in our September Letter. We believe that state insurance department regulation of fixed indexed annuity contracts is robust and effective. On the other hand, if proposed rule 151A were adopted, we believe, as discussed in our September Letter, that duplicative regulation would result at significantly increased costs to both consumers and fixed indexed annuity writers without any corresponding benefits.

---

31 NASAA Letter at 19.

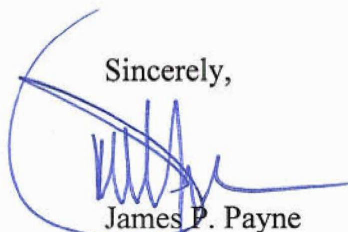
32 National Western notes that solvency regulation by state insurance departments protects purchasers of insurance contracts through measures designed to ensure both the continued viability of insurance company writers of insurance contracts as well as the ability of the company to honor the guarantees under the contract. National Western also notes that state insurance departments regulate the market conduct of insurance companies through requirements governing product approval, advertising, agent sales, the handling of complaints, replacements and recordkeeping as well as other requirements and are as dedicated to market conduct regulation as they are to solvency regulation.

SEC Regulation and Resources. In comparison to the experience and history of state insurance departments and the NAIC in regulating fixed indexed annuity contracts, the SEC and its staff are relatively devoid of experience in regulating fixed indexed annuity contracts. The SEC and its staff have not developed disclosure or other standards to govern these contracts, and lack at this time the experience and expertise, including, but not limited to, actuarial expertise, necessary for the competent regulation of these increasingly important retirement savings instruments. Moreover, the recent crisis in the financial markets calls into question the resources that the SEC would be able to dedicate to such a new major regulatory undertaking and whether accepting that undertaking would distract the SEC from what should be its primary focus, the regulation of the financial markets.

V. Conclusion

For the reasons stated above and as set forth in our September Letter, National Western respectfully requests that the Commission not adopt rule 151A.

Sincerely,



James P. Payne
Senior Vice President - Secretary
National Western Life Insurance Company

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

Andrew J. Donohue, Director, Division of Investment Management
Susan Nash, Associate Director, Division of Investment Management
William J. Kotapish, Assistant Director, Division of Investment Management
Keith E. Carpenter, Special Senior Counsel, Division of Investment Management
Michael L. Kosoff, Attorney, Division of Investment Management

APPENDIX A