AMERICAN ACADEMY *of* ACTUARIES

November 17, 2008

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

Re: Follow-up Comments on Release Nos. 33-8976 & 34-58759 (File No. S7-14-08): Proposed Rule 151A

Dear Ms. Harmon:

The American Academy of Actuaries' Indexed Annuity Work Group (Academy WG) appreciates the opportunity to provide additional comments to the Securities and Exchange Commission on Proposed Rule 151A. It is the intent of these comments to further develop some of the themes and issues set forth in our initial submission on September 10, 2008.

As you may recall from our initial comments, the Academy WG focused on three major themes. First, we identified the traditional distinctions between securities and insurance products, including the objectives of the purchaser, the insurer's assumption of risk, principal guarantees, and other contractual characteristics, which together provide a firmly established distinction between these two classes of financial products. Next, the comments identified key issues with the criteria set forth by Proposed Rule 151A for establishing an annuity as a security. Among these concerns were internal inconsistencies among the criteria, consumer impacts, and the absence of a safe harbor to clearly establish which products are considered to be insurance. Finally, the Academy WG proposed some alternative approaches for resolving concerns about indexed annuities outside of Proposed Rule 151A, especially working with state insurance regulators to strengthen the disclosures and sales practices used in the sale of these products.

In this second set of comments, the Academy WG will be supplementing its original remarks by addressing the following items:

- *Differences between Investment and Insurance Products* – To reinforce some of the key differences between securities and insurance products outlined previously, we have attached several charts to illustrate the varying outcomes between these types of financial products.

- *Indexed Annuity Disclosure (Objectives and Alternatives)* – We suggest steps for improving sales practices and customer understanding of indexed annuities in cooperation with state regulators.

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- *Concepts for Constructing a Safe Harbor Framework for Indexed Annuities* – We provide considerations and proposed elements for the establishment of an indexed annuity Safe Harbor as proposed in our initial comments.

- *Clarification of Insurance Status of Traditional Products* – We have developed language to more clearly exclude traditional insurance products if the decision is made to proceed with Proposed Rule 151A.

- *Distinctions between Indexed Annuity Products and Variable Annuities*. – We clarify some of the differences between these products, as a number of comments have demonstrated to us a widespread misunderstanding of the nature of Indexed vs. Variable Annuities.

I. Differences between Insurance and Investment Products

The attached charts 1-3 (See Appendix) represent some illustrative examples of realized results for insurance versus security products. We picked three time periods. The first (1999-2008) shows an early decline in the market followed by a recovery. The second (2002-2008) shows essentially a growing market with some recent declines. And the third (2004-2008) shows a growing market followed by a return to its original (2004) value[1]. We think the following concepts summarize the key insights shown in the charts:

1. The roller coaster effect of being in a security where values can change up or down on a daily basis.
2. The much more stable path of an indexed annuity where returns granted at the end of the year are "locked in" and can never be taken away.
3. The contrast between an instrument (a security) subject to a loss from market fluctuations and an insurance product where the only uncertainty is the amount of return above a guaranteed rate.
4. In comparison to a traditional annuity, the indexed annuity shows (in these three instances) how it has provided incremental value in the long run over the traditional annuity.

II. Indexed Annuity Disclosure - Objectives and Alternatives

Based on our analysis and discussions of the issues, the Academy WG believes the indexed annuity marketplace would benefit from 1) additional disclosure on how indexed annuity products work and 2) how they differ from investment type products. We suspect there is broad support for more extensive numerical disclosure and performance demonstrations for indexed products.

The Academy WG believes more extensive indexed annuity disclosure could be achieved within the existing regulatory framework with some coordinated guidance from the SEC and state

[1] The annuity products shown are illustrative. They are meant to reflect general relationships over the long run, not be an exact historical recreation. For example, for Chart One to fully reflect historical credits, both the Traditional and indexed annuity would have higher ultimate values, but the general relationships would still hold.

regulators. The NAIC and the state insurance departments are already pursuing a number of initiatives on indexed annuity disclosure and suitability. Additional involvement by the Academy WG and engagement of the SEC could offer new insights to enhance work on these existing initiatives.

The Academy WG could offer additional support by applying its expertise to the development of options for numerical disclosures and performance examples. In addition a request could be made to the Actuarial Standards Board, which is independent from the American Academy of Actuaries, to provide proper professional guidance through an Actuarial Standard of Practice. This guidance would support the regulatory codification of disclosures to prospective purchasers that would aid consumer understanding of indexed annuity products.

Purchase decisions will be better informed the more a prospective purchaser can understand both how their product works and what reasonable expectations are for its performance. Two categories of numerical disclosures could assist prospective purchasers.

1. Crediting mechanics examples - the objective here is to make sure the prospective purchaser understands how changes in an index will affect the value of his or her policy. The examples could show the account value development for some limited number of standard scenarios, assuming a standard premium amount. Results would be specific to the type of product, e.g., annual interest crediting or multi-year crediting, and crediting approach being used, e.g., participation rate, cap, spread fee, etc. Additionally, since an indexed annuity has several different benefit values (death, cash surrender and annuitization, for example) the examples could display each of these within the examples.

2. Distribution of realized returns - Returns could be computed for many scenarios, over, for example, a ten-year period, using the carrier's crediting parameters (participation rate, cap, etc.) with the results shown as a distribution of outcomes. The objective here is to give the consumer an understanding of the ranges of possible performance. The assumptions for generating the scenarios might be based upon a mathematical distribution (such as lognormal index paths, for example). Alternatively, the scenarios could be based on historical data, such as the actual market results seen by issuing the product every business day since 1950 or some other appropriate date. The presentation could be a distribution (like a histogram) of average annual returns over a 10-year period. We have included Chart 4 as an example of the kind of presentation possible for illustrating the distribution of these results.[2] This purpose of the disclosure is to demonstrate likely returns as well as the likely range of those returns from low to high.

Such additional disclosures will foster enhanced consumer understanding, but they will require regulatory consensus to carry out effectively and uniformly in a way that clearly shows the product dynamics. At the request of the SEC, the Academy WG would be glad to provide further detail on this issue.

[2] We have also included Chart 5 as a comparison of the distribution of returns for the S&P 500 over this same period.

III. Elements of an Indexed Annuity Safe Harbor Framework

The role of an actuary typically includes a variety of compliance responsibilities and members of the profession must therefore stay informed on state and federal regulations that impact their work. Actuaries who work specifically with indexed annuities must satisfy themselves that nonregistered indexed annuity products are in compliance with the law. As we pointed out in our prior submission, the current proposed Rule 151A contains no concept of a safe harbor to determine if an indexed annuity (or other product) is not a security. In this section we describe the analytical framework through which actuaries have evaluated products to ensure compliance with existing regulations. The Academy WG recommends the criteria below as a possible basis for the creation of such a safe harbor.

One criteria used is to ensure sufficient investment risk has been shifted from the prospective purchaser to the carrier. The analysis framework commonly used for nonregistered indexed annuities draws on the SEC's Rule 151 together with existing securities case law. The approach is to consider whether an indexed annuity product displays the following characteristics:

1) Meets the minimum value guarantee requirements of the NAIC Standard Nonforfeiture Law for Individual Deferred Annuities (SNFL);
2) Adjusts its excess interest formula no more frequently than annually; and
3) Is marketed with emphasis on safety of principal and the provision of retirement income, rather than on investment features (Marketing Test).

A product meeting these three criteria is then generally, but not always, considered to be an insurance product rather than a security. However, actuaries may also consider other factors to supplement these basic considerations. Some actuaries consider the strength of the guarantee being offered by the carrier. This has commonly been measured by the duration required for the annuity contract to "break even" on a guaranteed basis, if surrendered. This is the duration the client, upon surrendering the annuity contract, is first guaranteed an amount no less than the premium paid.

The use of such a breakeven test in some design objectives (and also the Marketing Test described above), stems from a 1967 US Supreme Court case in which a deferred annuity contract was found to be a security, due in part to weak guarantees. (*SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 1967) In this case, the contract offered by United Benefit never broke even on a guaranteed basis. In contrast, indexed annuity designs currently available in the marketplace do break even on a surrender basis at some time during their life.

While indexed annuities are intended to be used as long-term purchases, there may be reasons to surrender the policy after a few years, in which case the purchaser may have expectations about what is a reasonable period after which he or she should be guaranteed at least the return of principal. There is no specific "right" answer, but a range of four years in a high interest environment to eight years in a low interest environment could be a possibility. Therefore, the Academy WG suggests that, in addition to the three criteria outlined above, a fourth condition could be added as an explicit requirement to consider in designing a safe harbor framework for indexed annuities:

4) The policy breaks even if surrendered subsequent to the specified breakeven policy anniversary.

However, the details for this will need to consider that surrender charges and nonforfeiture values relate both to the issue of recovering expenses as well as a mechanism to ensure equity between terminating and persisting policyholders. Thus, one consideration in developing the breakeven requirement is to ensure that the impact on pricing and policyholder values does not create unintended consequences.

IV. Clarifying Insurance Status of Traditional Products

We continue to have reservations and difficulties with proposed Rule 151A. The Academy has for some time advocated in many arenas that principle-based regulation will provide sounder and more comprehensive solutions. Rules are not well suited to providing clear direction in a competitive and evolving market place. However, if the SEC continues with its intent to define a rule to characterize indexed annuities as securities, we believe that there should be additional clarity so other types of insurance products are not unintentionally brought within the scope of such a rule. For your consideration, we have identified two ways to accomplish this.

The first approach, which would be our preference, is to clarify within existing Rule 151 that insurance products containing certain characteristics are not securities. This would be beneficial to prospective purchasers and carriers, regardless of any decisions eventually made with respect to regulation of indexed annuities. Accordingly, we think that the SEC should consider adding wording similar to the following to existing Rule 151:

> For greater clarity, the insurer shall also be deemed to assume the investment risk under the contract if:
> (i) non-guaranteed credits are payable as dividends declared by an insurer's board of directors; or
> (ii) interest credits are determined prospectively no more frequently than annually, and credits may be determined, in whole or in part, by contractual reference to the performance of an index other than an equity index.

An alternative approach is to limit the applicability of proposed Rule 151A. Wording to achieve this could be similar to:

> Rule 151A is not applicable to an annuity contract or optional annuity contract,
> (a) under which amounts payable by the issuer under the contract are not calculated, in whole or in part, by contractual reference to the performance of an equity security, including a group or index of equity securities;
> (b) for which interest credits are determined prospectively; or
> (c) for which non-guaranteed credits are payable as dividends declared by an insurer's board of directors.

V. Risk/Reward Differences Between an Indexed Annuity and a Variable Annuity (or any Security) with Guarantees

In reading the comments on Proposed Rule 151A submitted by other parties, we noticed a misunderstanding by some of the contributors where they described an indexed annuity as being essentially similar to a variable annuity with guarantees. Some might ask, since both products change in value based on changes in the market, aren't the risks essentially the same? In fact, they are not. They differ in several important ways and these differences alter the level and ranges of ending results in a substantive manner. By way of a loose analogy, while a defined benefit pension plan and a 401(k) plan may both be considered retirement vehicles, they have very different risk characteristics and ending results for the retiree. One is meant to provide guaranteed retirement income and the other is only an accumulation vehicle. Regulations drafted to apply equally to both will likely result in only confusion for the end consumer. Similarly, from an engineering standpoint there are important structural risk differences between the indexed annuity and securities with guarantees. This is why we are concerned that the current solution proposed by Rule 151A does not adequately address the differences between insurance and investment products. Two of the more notable differences are:

1. Volatility in values experienced by the consumer over the horizon of the product.
   Independent of the actual ending values, from the consumer standpoint, one value of an indexed annuity product is the peace of mind that comes from not having to ride the "roller coaster" along the way to get to the ending result.

2. The differences in the guarantees being provided by the two products
   Indexed annuities provide short-term guarantees that operate continuously and build to also provide a long-term guarantee. There is no period during which value can be lost. In contrast to this, variable annuities with living benefits provide guarantees that are effective only over the long term. Even with guarantees, variable annuities have extensive periods during which the account value can decrease. Variable annuities with a Guaranteed Maturity Account Balance provide no floor protection until a single point in time, which may be ten years after purchase. Similarly, a Guaranteed Maturity Income Benefit provides no protection until ten years, at which time it still will leave the purchaser at risk of subsequent loss of value if the benefit is not in-the-money. A Guaranteed Maturity Withdrawal Benefit and a Guaranteed Living Withdrawal Benefit may be activated at any time, but there is no protection against decreases in account value until the account value has been depleted, at which time the guarantee slowly adds value.

Both indexed annuities and variable annuities with living benefit guarantees provide value, but they are very different products. Indexed annuities give away the possibility of home run "wins" in return for no downside "losses" and a more certain and narrowly dispersed return.

Thank you for the opportunity to present these comments. We hope that the information and recommendations contained herein are helpful to you in determining your next steps in regards to this matter.

Sincerely,

David Sandberg, FSA, MAAA, CERA

American Academy of Actuaries'
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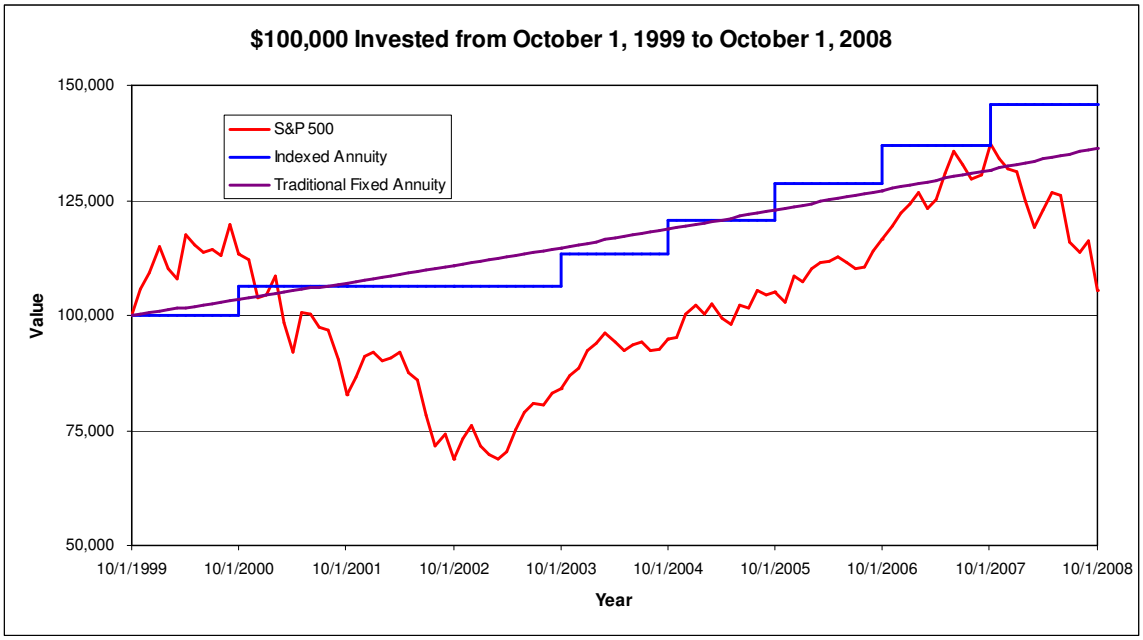
APPENDIX

CHART ONE

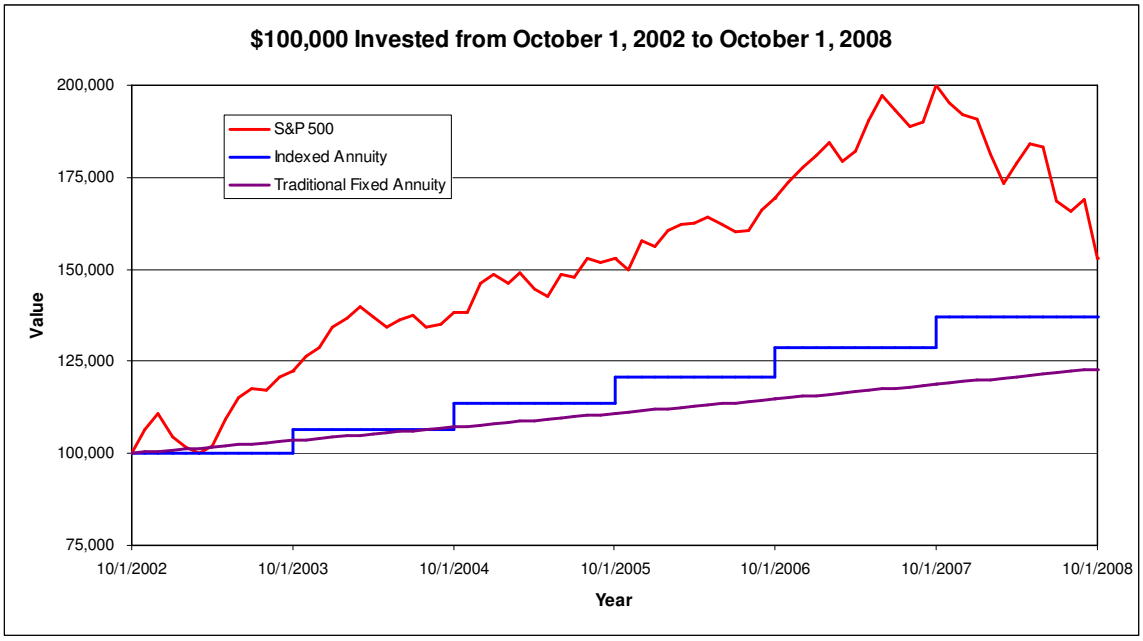
A comparison of a $100,000 premium deposit into an indexed annuity, a $100,000 investment directly into the S&P500 and a $100,000 premium deposit into a Traditional Fixed Annuity

1. Indexed Annuity: Annual Point-to-Point with 6.5% cap, invested in S&P 500 Index (excluding dividends)
2. S&P500 Investment: Includes reinvested dividends from the S&P500
3. Traditional Annuity: Annual interest rate of 3.5% credited daily



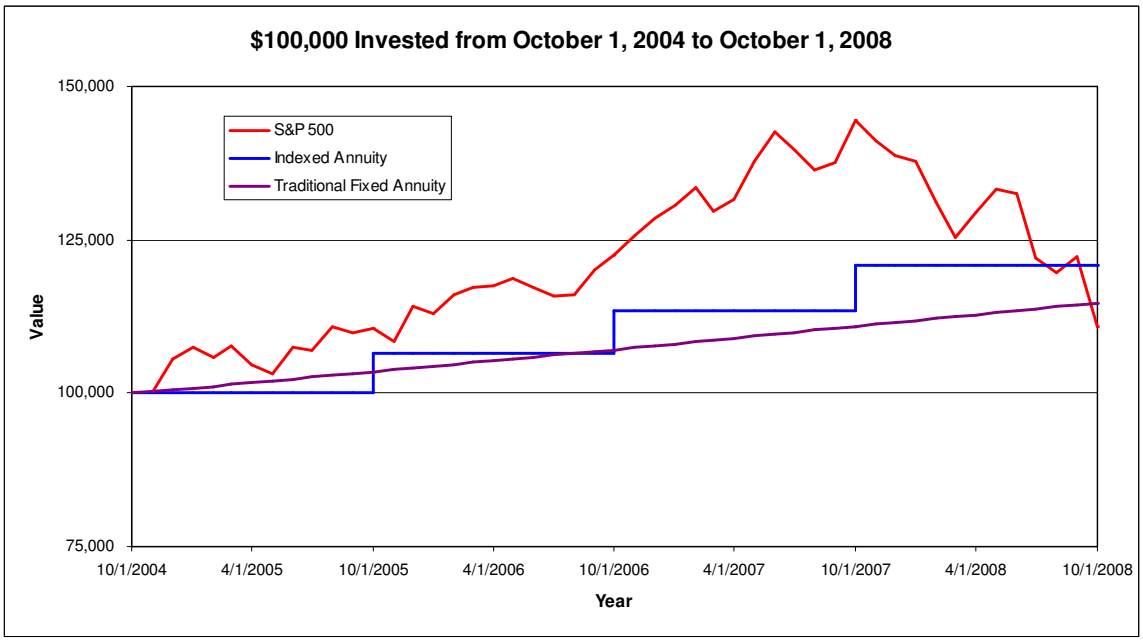
	Annual Return			Average Annualized Cumulative Return		
Year	S&P 500	Indexed Annuity	Traditional Fixed	S&P 500	Indexed Annuity	Traditional Fixed
2000	13.3%	6.5%	3.5%	13.3%	6.5%	3.5%
2001	-26.8%	0.0%	3.5%	-8.9%	3.2%	3.5%
2002	-17.1%	0.0%	3.5%	-11.7%	2.1%	3.5%
2003	22.3%	6.5%	3.5%	-4.2%	3.2%	3.5%
2004	13.1%	6.5%	3.5%	-1.0%	3.9%	3.5%
2005	10.6%	6.5%	3.5%	0.8%	4.3%	3.5%
2006	10.8%	6.5%	3.5%	2.2%	4.6%	3.5%
2007	18.0%	6.5%	3.5%	4.0%	4.8%	3.5%
2008	-23.3%	0.0%	3.5%	0.6%	4.3%	3.5%

CHART TWO



	Annual Return			Average Annualized Cumulative Return		
Year	S&P 500	Indexed Annuity	Traditional Fixed	S&P 500	Indexed Annuity	Traditional Fixed
2003	22.3%	6.5%	3.5%	22.3%	6.5%	3.5%
2004	13.1%	6.5%	3.5%	17.6%	6.5%	3.5%
2005	10.6%	6.5%	3.5%	15.2%	6.5%	3.5%
2006	10.8%	6.5%	3.5%	14.1%	6.5%	3.5%
2007	18.0%	6.5%	3.5%	14.9%	6.5%	3.5%
2008	-23.3%	0.0%	3.5%	7.4%	5.4%	3.5%

CHART THREE



	Annual Return			Average Annualized Cumulative Return		
Year	S&P 500	Indexed Annuity	Traditional Fixed	S&P 500	Indexed Annuity	Traditional Fixed
2005	10.6%	6.5%	3.5%	10.6%	6.5%	3.5%
2006	10.8%	6.5%	3.5%	10.7%	6.5%	3.5%
2007	18.0%	6.5%	3.5%	13.1%	6.5%	3.5%
2008	-23.3%	0.0%	3.5%	2.6%	4.8%	3.5%

The following is an example of the return on a product where the policy is issued on every business day since 1950. The results shown in this example reflect what could be obtained from an indexed annuity with a 5% bonus and an annual point to point crediting method with a 7% cap. The chart below summarizes the distribution of results ten years after the issue date for each policy. This example is only provided here to illustrate the type of disclosure that could be provided.

CHART 4

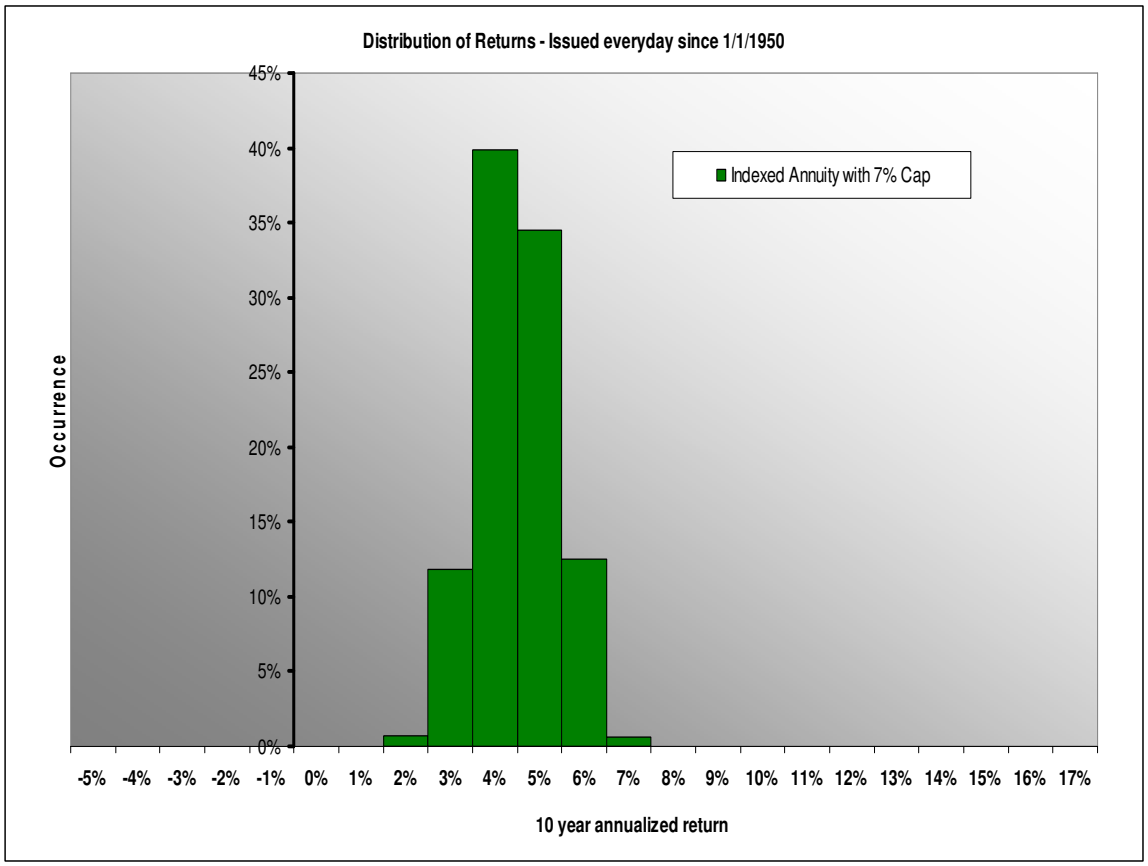
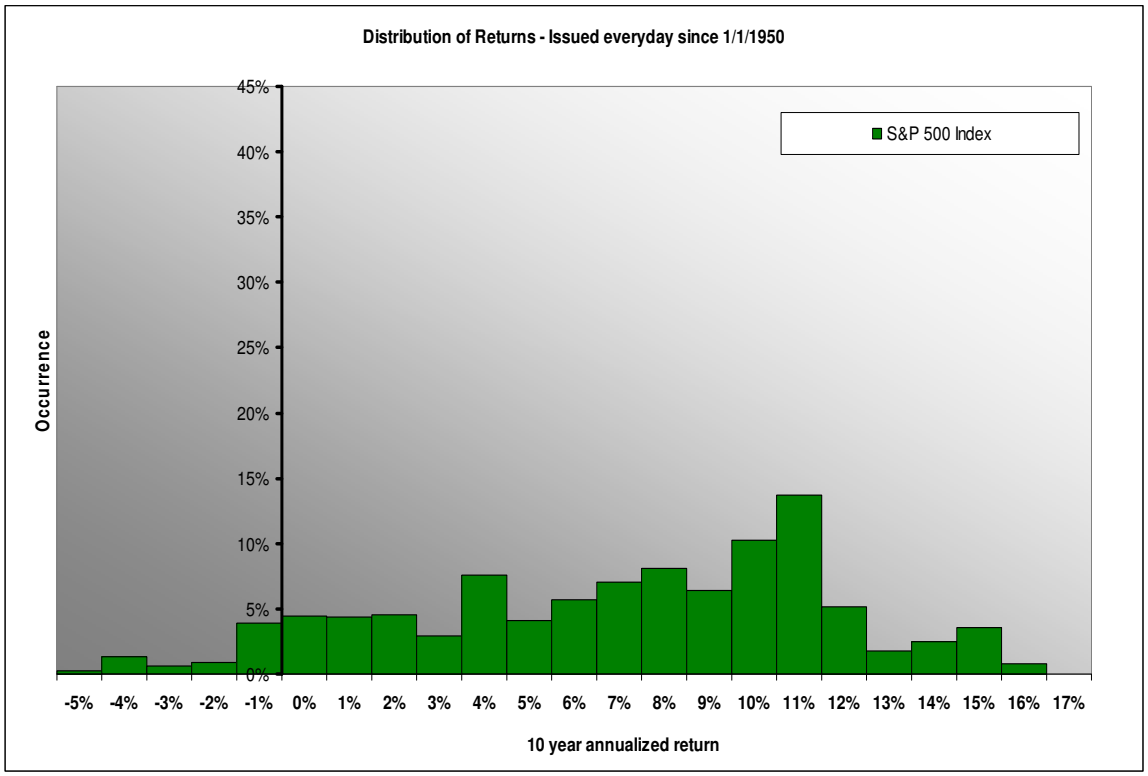


CHART 5


Distribution of Returns - Issued everyday since 1/1/1950
S&P 500 Index
Occurrence
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
-5% -4% -3% -2% -1% 0% 1% 2% 3% 4% 5% 6% 7% 8% 9% 10% 11% 12% 13% 14% 15% 16% 17%
10 year annualized return