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November 12, 2008

The Honorable Kathleen L. Casey  
Commissioner  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

RE: Supplemental Comment Regarding Indexed Annuities and Certain Other Insurance Contracts File  
No. S7-14-08; Meeting with the Honorable Kathleen L. Casey

Dear Commissioner Casey:

It was a pleasure meeting with you and Jim Burns on Monday, October 20<sup>th</sup> regarding our concerns with respect to proposed Rule 151A and the chilling impact Rule 151A would have upon Fixed Indexed Annuities (“FIAs”) business. I appreciate the time you spent with Tom McDonald and me on this issue which is critical to consumers, producers and insurers.

In our conversation you requested additional information. I enclose the following in response to your requests, and in the form of a comment letter on behalf of Old Mutual Financial Network (“Old Mutual”) as a supplement to Old Mutual’s opposition comment letter dated September 10, 2008. (Copy attached.) To this end, I am copying Ms. Florence Harmon of the Commission and will forward a copy to her directly.

**Relationship of S&P to FIA Sales:**

I attach a chart which compares the generally inverse relationship between S&P performance and FIA sales. Specifically, during times when the S&P is increasing, FIA sales growth generally declines. Conversely, during times when the S&P is decreasing, FIA sales growth increases; sometimes markedly such as the down markets of 2000, 2001 and 2002.

If in fact the primary reason for purchasing an FIA is to participate in the market, then FIA sales would correlate to the movement of the S&P. However, as the comparison demonstrates, during times of greatest decline in the S&P, FIA sales increase greatly – evidence of a flight to safety in guaranteed products and from investment risk products.

**Responsiveness to LIMRA CAP:**

As I shared during our meeting, Old Mutual participates in the LIMRA Customer Assurance Program (“LIMRA CAP”) which surveys purchasers of Old Mutual annuities regarding their understanding of the product and their assessment of the sales process.

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Follow-up Letter to Commissioner Casey

As part of Old Mutual's Suitability Review system, our Compliance Department reviews any written comments provided on the LIMRA CAP form. (Sample attached.)

You inquired as to how many of the 100% of FIA purchasers surveyed by Old Mutual actually submit a response. In response, I enclose an excerpt from Old Mutual's LIMRA CAP report of 9/30/08 which shows a response rate of 22% for July and a rolling twelve-month response rate of 25%.

**NAIC Consumer Complaint by Type of Insurance:**

You had also asked for additional information regarding Fixed Indexed Annuity complaints. I attach in response, material collected by the National Association of Insurance Commissioners with respect to "closed complaints." At page 3 of 5, you will note that the information gathered by the NAIC demonstrates that complaints involving indexed annuities for 2005 to June 2008 are less than complaints involving variable annuities or non-indexed fixed annuities. This information can be found at:

[https://eapps.naic.org/documents/cis\\_aggregate\\_complaints\\_by\\_coverage\\_types.pdf](https://eapps.naic.org/documents/cis_aggregate_complaints_by_coverage_types.pdf)

In addition, I include a breakdown of consumer complaints experienced by Old Mutual Financial. As you can see, expressed as a percentage of outstanding Indexed Annuity policies, Old Mutual Financial has experienced the following percentages of Indexed Annuity complaints from 2005 through 9/30/08, inclusive, for each respective period: 0.12%, 0.23%, 0.2%, 0.18%.

**State Suitability Requirements:**

During our meeting we discussed the fact that all members of the Coalition for Indexed Products<sup>1</sup> apply annuity suitability standards in all U.S. jurisdictions. This is driven in large part by the fact that 41 U.S. jurisdictions have specifically adopted annuity suitability laws or regulations. For your information, I attach a copy of an ACLI regulatory survey identifying the individual states. Specifically, 29 states have adopted the NAIC model regulation for all transactions, 6 have adopted the NAIC version for seniors and 6 have adopted non-NAIC specific requirements. In addition, 6 additional states have Annuity Suitability regulation or legislation pending.

**Chilling Effect with Respect to Rural Product Offerings:**

During our meeting I shared with you that certain insurance agencies serving the 403(b) qualified annuity market for teachers in remote, rural areas are concerned about the chilling effect Rule 151A will have upon serving these types of markets. Specifically, agencies and the insurance companies that they serve have voiced the concern that the additional supervision requirements imposed upon remote, rural offices by FINRA will cause certain agents and agencies to abandon these markets. To best respond to your request for

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<sup>1</sup> The Coalition's member companies are Allianz Life Insurance Company of North America, American Equity Investment Life Insurance Company, Aviva Life and Annuity Company, Conseco Insurance Company, EquiTrust Life Insurance Company, Life Insurance Company of the Southwest (a National Life Group company), Midland National Life Insurance Company, National Western Life Insurance Company, North American Company for Life and Health Insurance, OM Financial Life Insurance Company (an Old Mutual company), and OM Financial Life Insurance Company of New York.

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Follow-up Letter to Commissioner Casey

follow-up information on this important point, I have referred your concern to a company within the Coalition for Indexed Products, Life Insurance Company of the Southwest, and one of their agency's that serve the remote, rural market in the southeastern part of the US. They will be following up with you directly (and copying Ms. Harmon of the SEC).

Thank you again for your time and consideration.

Sincerely,

A handwritten signature in black ink, appearing to read 'E. Marhoun', with a long horizontal flourish extending to the right.

Eric L. Marhoun  
Senior Vice President, General Counsel

Attachments

cc: Florence Harmon, Acting Secretary – Securities and Exchange Commission  
Susan Jennings, General Counsel – Life Insurance Company of the Southwest  
Tom McDonald, Baker & Hostetler

September 10, 2008

Ms. Florence E. Harmon  
Acting Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-9303

Re: Indexed Annuities and Certain Other Insurance Contracts  
File No. S7-14-08

Dear Ms. Harmon:

Old Mutual Financial Network (“Old Mutual”)<sup>1</sup> is pleased to have the opportunity to offer its comments in response to the request by the Securities and Exchange Commission (the “Commission” or “SEC”) in Release No. 33-8933<sup>2</sup> (the “Proposing Release”) for comments on proposed rule 151A that would define certain indexed annuities as not being “annuity contracts” or “optional annuity contracts” under Section 3(a)(8) of the Securities Act of 1933 (the “1933 Act”).

Old Mutual opposes adoption of proposed rule 151A. The first section of this letter addresses our concern regarding the lack of need for the proposed rule particularly in light of state insurance disclosure and sales practice protections. The second and third sections discuss potentially significant collateral damage the rule may cause the non-indexed business of insurance arising from the breadth of the rule. The fourth section notes serious inconsistencies between the proposed rule, Section 3(a)(8), and guiding precedent. The last section outlines the proposed rule’s adverse impact on consumers as they will bear the costs of the rule.

## **I. THE PROPOSING RELEASE DOES NOT ESTABLISH A NEED FOR FEDERAL REGULATION**

The Proposing Release states “purchasers of indexed annuities have not received the benefits of federally mandated disclosure and sales practice protection,”<sup>3</sup> cites “complaints of abusive sales

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<sup>1</sup> Old Mutual Financial Network (“Old Mutual”) is the marketing name for the U.S. life insurance and annuity operations of Old Mutual plc. Working through its network of established insurance companies (OM Financial Life Insurance Company, OM Financial Life Insurance Company of New York), Old Mutual is headquartered in Baltimore, MD; maintains a National Sales Office in Atlanta, GA, and service centers in Nebraska and Atlanta. The companies that comprise Old Mutual deliver a diverse portfolio of annuities and life insurance products via an established group of master general agents. Products are distributed in 50 states and the District of Columbia. Old Mutual has nearly one million policyholders nationwide. As of June 30, 2008, Old Mutual had \$18 billion in statutory-basis assets.

<sup>2</sup> See Indexed Annuities and Certain Other Insurance Contracts, Rel. No. 33-8933, 34-58022 (June 25, 2008).

<sup>3</sup> Proposing Release at 6.

practices,”<sup>4</sup> and states that protections provided by these contracts are “not...substantial enough.”<sup>5</sup> Yet it fails to produce evidence of abusive sales practices, fails to acknowledge state regulation of disclosure and sales practices, and disregards state regulation of guarantees.

#### **A. No Empirical Evidence Has Been Provided**

The Proposing Release identifies consumer protection, especially protection of seniors, as one of the driving needs in support of the rule.<sup>6</sup> As evidence of this need the Proposing Release cites the statement of Patricia Struck, then President of the North American Securities Administrators Association (“NASAA”), at the first Senior Summit in June, 2006.<sup>7</sup> In her statement, Ms. Struck reports survey data NASAA obtained from its members about complaints involving indexed annuities and complaints involving variable annuities.<sup>8</sup> Because Ms. Struck’s statement reports this information in the aggregate, and not separately for indexed annuities, these survey results effectively preclude meaningful analysis of this body of evidence by the Commission and the public. It certainly does not warrant the extrapolation of nontransparent combined results to the entire population of indexed annuity plans currently available in the U.S. retirement market place.<sup>9</sup> At the same time, the Proposing Release fails to mention, consider or analyze any of the consumer protection safeguards adopted by state insurance regulators to protect purchasers of the non-registered indexed annuities. In short, the SEC has failed to provide any empirical data regarding abuses related to the sale of indexed annuity contracts that would implicate a federal interest.

#### **B. The Proposing Release Fails to Acknowledge State Regulation of Disclosure and Sales Practices**

Since indexed annuity contracts were first introduced in the mid-1990s they have been uniformly regulated under the supervision of state insurance regulators and state insurance law as fixed annuity contracts. This uniform state insurance regulatory treatment of indexed annuities is significant in determining status of contracts under Section 3(a)(8) and differs from the uncertain

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<sup>4</sup> Proposing Release at 8.

<sup>5</sup> Proposing Release at 26.

<sup>6</sup> See Proposing Release at 8, 15-17.

<sup>7</sup> See Proposing Release Note 25, at 16.

<sup>8</sup> *Id.* Ms. Struck states “The NASAA survey also found that unregistered securities, variable annuities and equity-indexed annuities are the most pervasive financial product involved in senior investment fraud. In California, 75 percent of the state’s senior investment fraud cases involve unregistered securities. Cases involving variable or equity-indexed annuities were 65 percent of the caseload in Massachusetts, 60 percent of the caseload in Hawaii and Mississippi.” We urge the SEC to publish the entire survey, including the survey instrument and all data gathered in the survey, to permit its review by interested parties. Details of the survey do not appear to be publicly available on NASAA’s website or otherwise.

<sup>9</sup> Old Mutual has received fewer than 3 complaints per thousand in-force indexed annuity contracts for calendar years 2005, 2006, 2007 and through June 30, 2008.

state insurance regulatory status of the variable annuity contract noted by the U.S. Supreme Court in SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) (“VALIC”).<sup>10</sup>

The state insurance regulatory landscape surrounding indexed annuities includes state insurance disclosure and sales practice regulation which the Proposing Release fails to consider. It also includes standard nonforfeiture laws—part of insurer solvency regulation which the Proposing Release recognizes and gives deference to in the context of proposed rule 12h-7<sup>11</sup>—which establish the minimum guarantees provided by indexed annuities.

### **1. State Regulation of Disclosure and Sales Practices Obviates the Need for Federal Regulation**

In the cost/benefit analysis of the Proposing Release, the Commission states:

Disclosures that would be required for registered indexed annuities include information about costs (such as surrender charges); the method of computing indexed return (*e.g.*, applicable index, method for determining change in index, caps, participation rates, spreads); minimum guarantees, as well as guarantees, or lack thereof, with respect to the method for computing indexed return; and benefits (lump sum, as well as annuity and death benefits). We think there are significant benefits to the disclosures provided under the federal securities laws.<sup>12</sup>

The Annuity Disclosure Model Regulation<sup>13</sup> provides disclosure standards to protect consumers and foster consumer education. The regulation specifies the minimum information which must be disclosed and the method for disclosing it. In particular, the following disclosures must be given in the form of a written disclosure statement at point of sale under Section 4 B. of the regulation:

At a minimum, the following information shall be included in the disclosure document required to be provided under this regulation:

- (1) The generic name of the contract, the company product name, if different, and form number, and the fact that it is an annuity;
- (2) The insurer’s name and address;

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<sup>10</sup> The *VALIC* Court observed that state insurance regulatory treatment of the then new variable annuity was far from uniform:

Some States deny these “annuity” contracts any status as “insurance”. Others accept them under their “insurance” statutes. It is apparent that there is no uniformity in the rulings of the States on the nature of these “annuity” contracts.

359 U.S. 65, 69.

<sup>11</sup> Proposing Release at 47.

<sup>12</sup> Proposing Release at 70.

<sup>13</sup>NAIC 245-1. The goal of this regulation is to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts.

- (3) A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate:
  - (a) The guaranteed, non-guaranteed and determinable elements of the contract, and their limitations, if any, and an explanation of how they operate;
  - (b) An explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;
  - (c) Periodic income options both on a guaranteed and non-guaranteed basis;
  - (d) Any value reductions caused by withdrawals from or surrender of the contract;
  - (e) How values in the contract can be accessed;
  - (f) The death benefit, if available and how it will be calculated;
  - (g) A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and
  - (h) Impact of any rider, such as a long-term care rider.
- (4) Specific dollar amount or percentage charges and fees shall be listed with an explanation of how they apply.
- (5) Information about the current guaranteed rate for new contracts that contains a clear notice that the rate is subject to change.

Finally, in addition to requiring a product-specific disclosure statement, the Annuity Disclosure Model Regulation also requires delivery of the Buyers Guide for Equity-Indexed Annuities.<sup>14</sup>

State insurance departments undertake an exacting review of each indexed annuity contract before the contract may be offered in the state. In connection with that review, state insurance regulators typically request very detailed information about the contract and practices regarding the offer and sale of the contract. State insurance regulators may condition the sale of a particular indexed annuity on prior regulatory review. Notably, this review generally includes a review of the product-specific disclosure statement and related materials.<sup>15</sup> Indexed annuity disclosure statements and related marketing materials are made to conform to applicable insurance laws in each jurisdiction where the product is sold.<sup>16</sup>

Disclosures the SEC finds important are being given under state insurance laws regulating disclosure and sales practices. Proposed rule 151A will result in a duplication of disclosure at

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<sup>14</sup> For examples of this specialized state insurance regulatory disclosure for equity-indexed annuities, *see* [http://www.idfpr.com/doi/life\\_annuities/equityindex.asp](http://www.idfpr.com/doi/life_annuities/equityindex.asp) and <http://www.dora.state.co.us/Insurance/regs/4-1-12%20attach.pdf>.

<sup>15</sup> *See, e.g.,* Minnesota Department of Commerce, Checklist for Annuities, [http://www.state.mn.us/mn/externalDocs/Commerce/Annuities\\_031103093332\\_1h45chk.pdf](http://www.state.mn.us/mn/externalDocs/Commerce/Annuities_031103093332_1h45chk.pdf) (requiring insurers provide “a copy of the disclosure statement that will accompany contracts, i.e., a form that the policyholder signs, certifying that he/she understands the key features of the contract, which features shall be addressed clearly and completely in the disclosure document”).

<sup>16</sup> Section 9 of the Advertisements of Life Insurance and Annuities Model Regulation requires insurers maintain advertising files and requires an authorized officer to state, as part of the insurer’s annual statement filed with the insurance commissioner, that advertisements disseminated by or on behalf of the insurer in the state during the preceding statement year “complied or were made to comply in all respects with the provisions of these rules and the insurance laws of this state.”

the consumer's expense and without any added benefit to the consumer. We believe the Commission must take into account the nature, extent and effectiveness of state insurance disclosure and sales practice regulation both in evaluating the need for the regulatory protections of the federal securities laws and in making the required cost/benefit analysis related to proposed rule 151A. The cost/benefit analysis is deficient in that regard because the Commission has ignored state insurance laws regulating disclosure and sales practices.

In addition to the Annuity Disclosure Model Regulation, the growing body of state insurance disclosure and sales practice regulation we believe the Commission should consider in this rulemaking proceeding include the following:

- The Suitability in Annuity Transactions Model Regulation<sup>17</sup>
- The Insurance and Annuity Replacement Model Regulation<sup>18</sup>
- The Advertisements of Life Insurance And Annuities Model Regulation<sup>19</sup>
- State "free look" requirements<sup>20</sup>
- State oversight and approval of products and related product disclosure, including the work of the Interstate Insurance Product Regulation Commission<sup>21</sup>
- State insurance unfair trade practice law and regulation<sup>22</sup>

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<sup>17</sup> Initially adopted by the National Association of Insurance Commissioners ("NAIC") in 2003 as the Senior Protection in Annuity Transactions Model Regulation, this regulation now applies without regard to the age of the purchaser. It establishes standards and procedures for recommendations to consumers in connection with annuity transactions. These standards insure that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed. In particular, Section 6 B. requires the insurance producer (or the insurer if no producer is involved) to make reasonable efforts to obtain information regarding the purchaser's financial and tax status, investment objectives and other information used or considered to be reasonable in making recommendations to the consumer.

<sup>18</sup> The purpose of this regulation is to regulate the activities of insurers and producers with respect to the replacement of existing life insurance and annuities by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions. The regulation assures that purchasers receive the information needed to make an informed purchase decision.

<sup>19</sup> This regulation establishes minimum standards and guidelines to assure a full and truthful disclosure to the public of all material and relevant information in the advertising of life insurance policies and annuity contracts.

<sup>20</sup> See Md. Code Ann. Ins. § 16-105(2008)(requiring notice prominently printed on the face of the annuity contract informing owner of right to cancel policy within 10 days of delivery). The Buyers Guide for Indexed Annuities calls attention to this right as follows: "When you receive your contract, read it carefully. It may offer a "free look" period for you to decide if you want to keep the contract. Ask your agent or insurance company for an explanation of anything you don't understand. If you have a specific complaint or can't get the answers you need from your agent or company, contact your state insurance department."

<sup>21</sup> See note 15 *supra* and Interstate Insurance Product Regulation Commission, Rule Establishing Uniform Standards for Index-Linked Interest Crediting Features for Deferred Non-Variable Annuity Products (May, 2008) [http://www.insurancecompact.org/rulemaking\\_records/080530\\_index\\_linked\\_crediting.pdf](http://www.insurancecompact.org/rulemaking_records/080530_index_linked_crediting.pdf).

<sup>22</sup> See *e.g.*, Md. Code Ann. Ins. § 27-102(prohibiting unfair trade practices); Md. Code Ann. Ins. § 27-202—216 (defining unfair and deceptive acts and practices);COMAR 31.15.01(unfair trade practices in advertising);COMAR 31.15.04 (unfair trade practices in solicitation of annuity contracts).

- State insurance department market conduct examinations<sup>23</sup>
- Enforcement actions by state insurance regulators and state attorneys general<sup>24</sup>

Proponents of proposed rule 151A may argue that the Commission should ignore various model regulations or laws noted above for the Commission's review which have not been promulgated or enacted in every jurisdiction. In this regard, the Commission should consider that insurers doing business throughout the United States routinely develop one disclosure form for each product and then use it in all jurisdictions where they conduct business, including jurisdictions that have not yet adopted particular NAIC model laws or regulations. The Commission followed a similar path when it set the specified rate of interest under Rule 151(b).<sup>25</sup>

The Commission's Division of Investment Management previously observed that Justice Brennan "in declaring that state insurance law did not provide adequate protection to an investor in a mutual fund...*appeared to focus on the absence of disclosure requirements in state law*".<sup>26</sup> The world of insurance disclosure and sales practice regulation has evolved considerably since VALIC was decided on March 23, 1959. Today there is "no absence of disclosure requirements in state law" applicable to indexed annuity contracts. We urge the Commission to consider state insurance disclosure and sales practice protections.<sup>27</sup>

## 2. State Regulation of Minimum Values

Indexed annuities include important guarantees of principal and credited interest under state insurance solvency regulation designed to protect contractowners that did not apply to the

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<sup>23</sup> See, e.g., Vermont Department of Insurance  
[http://www.bishca.state.vt.us/InsurDiv/market\\_conduct\\_exams/a\\_marketconduct\\_reports2.htm](http://www.bishca.state.vt.us/InsurDiv/market_conduct_exams/a_marketconduct_reports2.htm)

Missouri Department of Insurance, Financial Institutions and Professional Registrations  
<http://insurance.mo.gov/cgi-bin/MCExamsList.pl>

<sup>24</sup> See, e.g., Pennsylvania Department of Insurance, Enforcement Actions, Michael J. Kman, Jr., Docket No. CO 00-01-002 (March 3, 2000) (Respondent sold three index annuity products and misrepresented to his clients that there would not be a surrender charge if their contracts were surrendered prior to maturity. After the sale, Respondent asserts he became aware of the surrender charge. The clients requested their annuity contracts be rescinded and the full amount of their deposits be refunded, which the insurer did. Respondent has been placed under a two year period of license supervision). <http://www.ins.state.pa.us/ins/cwp/view.asp?a=1276&q=528650&pp=3>

<sup>25</sup> Under Rule 151(b) the Commission tied the minimum rate required to be credited to the relevant nonforfeiture law in the jurisdiction in which the contract is issued, or, if the jurisdiction had not adopted such law, or no longer mandated that a minimum rate apply to existing contracts, then "the specified rate under the contract must at least be equal to the minimum rate then required for individual annuity contracts by the NAIC Standard Nonforfeiture Law." See Definition of Annuity Contracts or Optional Annuity Contracts, Rel. No. 33-6645 (May 29, 1986) (Adopting Release at 7) (hereinafter referred to as "Release 6645").

<sup>26</sup> Division of Investment Management, United States Securities and Exchange Commission, Protecting Investors: A Half Century of Investment Company Management, 393 at note 84 (May, 1992) (hereinafter referred to as "Protecting Investors") (emphasis added).

<sup>27</sup> We also urge the Commission to consider that in contrast to the well developed state regulation of disclosure applicable to indexed annuities, neither the proposed rule nor the Commission's Form S-1 include any disclosure standards specific to indexed annuities. Moreover, there is no office of the SEC charged with regulating these products. By contrast to state insurance regulators, the SEC has no experience whatsoever regulating indexed annuity contracts.

variable annuity considered by the Supreme Court in SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) (“United Benefit”).

In particular, state insurance nonforfeiture laws<sup>28</sup> set a floor for benefit payments by establishing the interest rate used to calculate these benefits and the minimum amount of the initial and subsequent purchase payments to which this rate must apply. Nonforfeiture laws were initially enacted to protect purchasers of insurance contracts—not to protect the insurance companies issuing the insurance contracts,<sup>29</sup> although they clearly play a supporting role in regulating insurer solvency today.<sup>30</sup>

In contrast to United Benefit’s Flexible Fund annuity, purchase payments under indexed annuities are insurer general account—not variable separate account—assets. The purchaser of an indexed annuity does not participate in the investment experience of the insurer’s general account. This fact is significant because state insurance nonforfeiture laws protect purchasers of general account deferred annuities, including indexed annuities, before annuity payments begin.<sup>31</sup> State insurance nonforfeiture laws *do not* protect purchasers of variable annuities<sup>32</sup> who

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<sup>28</sup> State nonforfeiture laws generally trace their origins to public outrage over tontine policies sold in the United States from the time of the Civil War until the early 1900s, when they were outlawed as a result of legislation adopted in New York in 1906. This legislation resulted from a recommendation of the Armstrong Committee investigations of the insurance industry in New York in 1905.

Under a tontine policy, a dividend was paid only if the insured survived the time period specified in the contract. In its report the Armstrong Committee noted that the three largest New York insurers at that time “sold mostly tontine policies on which dividends had fallen far short of the estimates made for policyholders at the time of purchase.” George A. Norris, *Voices from the Field – A History of the National Association of Life Underwriters* (National Association of Life Underwriters, 1989).

“Tontine insurance held certain appeals. The policyholder was offered the possibility of munificent returns on his investment if he adhered to his contractual agreement. Management, on the other hand, accumulated large amounts of capital since, unlike annual-dividend insurance, it did not have to disperse yearly payments. Furthermore, since the company did not pay a cash surrender value on tontine policies, lapsed money was not returned. This amount proved sizable; a twenty-five percent or higher lapse rate was common.” H. Roger Grant, *Insurance Reform Consumer Action in the Progressive Era*, 7 (The Iowa State University Press, 1979).

<sup>29</sup> See Alfred N. Guertin, *Developments in Standard Non-Forfeiture and Valuation Legislation*, *Journal of the American Association of University Teachers of Insurance*, Vol. 13, No. 1, 5-15 (Mar. 1946) (Discussing post-Armstrong investigation legislative initiatives, Guertin states at 7: “The conference of Governors, Attorneys General and Commissioners and its Committee of Fifteen was dealing with disclosures developed by [the Armstrong] investigation. *It was not an emergency involving the solvency of companies, however.* It is understandable, therefore, that their report did not contain recommendations on the matter of reserves from the standpoint of solvency of companies. *They were interested in the practices of companies in their relation to policyholders.*”)(Emphasis added).

<sup>30</sup> See, *i.e.*, Report of the American Academy of Actuaries’ Annuity Nonforfeiture Section 6 Work Group on Section 6 of the NAIC Model Standard Nonforfeiture Law for Individual Deferred Annuities (Boston, June, 2005), [https://www.actuary.org/pdf/life/nonforfeit\\_6\\_june05.pdf](https://www.actuary.org/pdf/life/nonforfeit_6_june05.pdf) (standard nonforfeiture law addresses insurer solvency, equity between surrendering and continuing policyholders and “smoothness”, *i.e.*, to gradually eliminate any difference between the cash surrender value of the surrendering policyholder and the paid up annuity value of the continuing policyholder as the policy approached maturity).

<sup>31</sup> See, *i.e.*, Md. Code Ann. Ins. § 16-501(7) (2008).

<sup>32</sup> See, *i.e.*, Md. Code Ann. Ins. § 16-501(4) (2008).

assume (“underwrite”) the risk that the surrender value of the variable annuity will be less than what they paid for it, and therefore receive the alternative protections of the federal securities laws which focus on disclosure in lieu of a state regulated guarantee of principal.

Importantly, the minimum guaranteed surrender values in *general account* indexed annuities are determined through state legislative processes regulating the business of insurance rather than being determined at the insurer’s discretion. The guaranteed surrender values in Old Mutual’s *general account* indexed annuities are determined in accordance with state insurance nonforfeiture laws which provide significantly stronger guarantees than the one considered and rejected by the Supreme Court in United Benefit.

Like all other deferred annuity contracts, indexed annuity contracts credit interest during the accumulation period.<sup>33</sup> The amount of interest an insurer is obligated to credit under a deferred indexed annuity contract is determined under the most favorable to the contract owner of two outcomes: (1) by a formula set forth in the contract which takes into account changes in a commercially published index of securities; or, (2) according to an annual minimum guaranteed rate of interest determined under state insurance nonforfeiture laws.

One state regulatory advocacy group seeking jurisdiction over indexed annuities blatantly ignores applicable state insurance law when it claims that guarantees under indexed annuities are “established by insurers in their discretion, usually at very low rates.”<sup>34</sup> In fact, minimum guarantees under these non-registered contracts are established by the Standard Nonforfeiture Law for Individual Deferred Annuities adopted through legislative process in 47 states and the District of Columbia.<sup>35</sup> These state insurance solvency laws protect purchasers of *general account* indexed annuities against the risk of “insignificant” guarantees like the one included in the *separate account* variable annuity examined by the Supreme Court in United Benefit.

In considering the issue of what constitutes an adequate guarantee of principal under an indexed annuity contract, the Commission should take into account that under state insurance solvency laws, insurers offering these contracts are not legally required to provide cash surrender values prior to maturity.<sup>36</sup> However, most insurers include a provision that allows for a lump sum settlement at maturity or at any other time before annuity payments begin.

When insurers include cash surrender and partial withdrawal rights in their indexed annuities, state nonforfeiture laws strike a balance between contractowners who hold their contracts until benefits begin and contractowners who elect to “cash out” before annuity payments begin. Long term insurance contracts are not demand deposit accounts; there is a significant cost to insurers

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<sup>33</sup> The Proposing Release at 9 states “During the accumulation period, the insurer credits the purchaser with a **return** that is based on changes in a securities index....” The insurer credits interest under an indexing formula; it does not pass through a “return.”

<sup>34</sup> NASAA’s Briefing Paper in Support of the SEC’s Proposed Rule on Equity Indexed Annuities, p. 1 (August 11, 2008).

<sup>35</sup> The Van Elsen Report, <http://www.veconsulting.com/resources/idanlmap.pdf> (August 30, 2005).

<sup>36</sup> See, *i.e.*, Md. Code Ann., Ins. § 16-503 (2008).

who provide the right to surrender a long term contract on any day.<sup>37</sup> Nevertheless, purchasers who elect to “cash out” of these contracts receive—at a minimum—the guaranteed cash value mandated under state nonforfeiture law.

The Commission noted in Release 6645 it had received a substantial number of comments requesting that it clarify proposed language in Rule 151(b)(2)(i) to avoid any appearance of favoring front-end loaded contracts over those that incorporate contingent deferred sales charges or defray sales and other expenses through a charge against contract value. In response to these comments, the Commission modified the rule slightly to adopt the substance of the suggested revisions. In doing so, the Commission noted that “the rule does not discriminate against contracts that do not have front-end charge structures.”<sup>38</sup>

Few states specifically cap commission rates; for those that don’t, state insurance nonforfeiture laws implicitly cap sales charges by requiring minimum cash surrender values in all indexed annuities that provide cash surrender values. In other words, no matter what the commission rate is on the contract, in a non-variable, non-registered fixed account indexed annuity, the insurer can never utilize a contingent deferred sales charge (surrender charge) that causes the value payable to the owner of the contract to fall below the minimum guaranteed amount under state insurance nonforfeiture laws.

The Proposing Release notes that under current state nonforfeiture laws, indexed annuities typically provide that the guaranteed minimum value is equal to at least 87.5% of purchase payments, accumulated at an annual interest rate of between 1% and 3%.<sup>39</sup> The Proposing Release further notes that, assuming application of the lowest state authorized guarantee of 87.5% of the premium accumulated at the lowest possible rate of one percent, it will take approximately 13 years for a purchaser’s guaranteed minimum value to equal 100% of the purchase payments.<sup>40</sup> The SEC’s current view that state insurance nonforfeiture guarantees are not “substantial enough”<sup>41</sup> stands in marked contrast to the favorable views previously expressed by its Division of Investment Management on the significant protections provided by state insurance nonforfeiture and reserve laws.

The Division of Investment Management in the context of recommending that the Commission propose amendments to the Investment Company Act to exempt variable insurance contracts from the charge restrictions in sections 26 and 27, instead requiring that charges under these contracts be reasonable in the aggregate, noted the comparable role played by state insurance nonforfeiture laws:

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<sup>37</sup> See, e.g., TIAA-CREF’s analysis of why it cannot afford to waive restrictions in its Traditional Annuity which does not provide lump-sum cash withdrawal benefits, and instead only allows participants to withdraw their funds from the Traditional Annuity in 10 annual installments. TIAA-CREF Traditional Annuity Contract 2007 Legislation – Optional Retirement Program (2008) [www.unf.edu/dept/humanres/articles/tiaa\\_cref\\_orp.pdf](http://www.unf.edu/dept/humanres/articles/tiaa_cref_orp.pdf).

<sup>38</sup> See Release 6645 at 6.

<sup>39</sup> See Proposing Release at 13.

<sup>40</sup> *Id.*

<sup>41</sup> Proposing Release at 26.

State insurance law, particularly its nonforfeiture provisions, is designed to achieve objectives that are similar to the restrictions of sections 26 and 27. Like section 27(d) of the Investment Company Act, nonforfeiture law protects contract owners from paying excessive charges by limiting an insurer's deduction when an owner voluntarily surrenders his or her contract. In deciding what is appropriate for an insurer to retain, state officials, through the nonforfeiture requirements, attempt to balance the extent to which an insurer has not recovered the expenses incurred in issuing the contract and the extent to which the surrendering contract owner has prepaid for services for which he or she will never receive. Because selling costs are usually a key component of unamortized expenses, nonforfeiture law, like section 27(d), helps to limit the amount of these expenses an insurer may keep.

Less directly, state reserve requirements, like sections 26 and 27 of the Investment Company Act, also protect a contract owner from paying excessive charges for contract services. The reserve requirements achieve this aim in two important respects: (1) by requiring that mortality costs be determined in accordance with prescribed mortality tables; and (2) by requiring that prepaid premiums or cash value be credited with a minimum rate of interest. While reserve requirements do not affect directly the amount of expenses that may be deducted under a contract, they generally assure the maintenance of minimum values so that guaranteed benefits can be provided.<sup>42</sup>

While numerous commenters have attacked commissions paid by some insurers as excessive, and the Commission has offered its view that minimum cash surrender values are not adequate ("we do not believe these protections are substantial enough"),<sup>43</sup> Congress has not yet repealed the McCarran-Ferguson Act and nothing in VALIC or United Benefit empowers the Commission to substitute its judgment for the applicable state legislature's determination of what "fraction of the benefits will be payable in fixed amounts" under fixed annuity contracts. One indexed annuity referenced in the Proposing Release<sup>44</sup> that is currently registered with the Commission offers sales commissions of up to 15%. Yet, to our knowledge, FINRA has not proposed a rule for registered indexed annuities similar to its Conduct Rule 2830 which prohibits FINRA members from offering investment company shares when aggregate sales charges exceed a certain level specified in the rule.

## II. THE PROPOSED RULE IS OVERLY BROAD ON ITS FACE

The Commission states in the Proposing Release that its proposed rule 151A "is intended to clarify the status under the federal securities laws of indexed annuities."<sup>45</sup> Contrary to the stated intent, proposed rule 151A *on its face*<sup>46</sup> does not limit the scope of its application to the

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<sup>42</sup> See Protecting Investors at 411-412.

<sup>43</sup> See Proposing Release at note 51 and accompanying text.

<sup>44</sup> See Proposing Release at note 17.

<sup>45</sup> Proposing Release at 5.

<sup>46</sup> See Proposing Release at 93-94.

regulation of certain indexed annuities. Instead, proposed rule 151A potentially sweeps within its ambit most of the general account life insurance and annuity contract business of U.S. life insurers. Proposed rule 151A, if adopted in its current form, effectively repeals or significantly amends Section 3(a)(8) in the absence of Congressional action to do so.

**A. The Overbroad Scope of Rule 151A Would Lead to Uncertainty in Interpretation And Application of the Rule**

All life insurance company general account products with cash values must credit current interest or determine values above guaranteed values by reference to performance of general account investments. Insurers must invest purchase payments they receive for general account indexed annuities in accordance with state insurance solvency laws regulating permitted investments. Importantly, these laws do not distinguish insurance company general account investments by type of product. Instead, these state insurance laws apply to the entire reserve an insurer is required to maintain for all general account products it sells. Depending on the products an insurer offers, this may include life, health and disability insurance as well as annuities.

For example, OM Financial Life Insurance Company, domiciled in Maryland, must comply with Maryland Insurance Code § 5-511(a-1) when it invests purchase payments it receives under its indexed annuities. This statute provides:

Each life insurer shall have and continually maintain an amount equal to its entire reserves, as required by this article, in any combination of the types of assets authorized by subsections (c) through (p) of this section subject to the limit, if any, set for each type or class of investment.

OM Financial Life Insurance Company must also comply with the cited statute when it invests the premiums it receives for its general account life insurance policies as well as when it invests the purchase payments it receives for its traditional fixed annuities.

The assets permitted under the quoted insurance regulatory law include various types of securities as defined in Section 2(a)(1) of the Securities Act. OM Financial Life Insurance Company accordingly holds various securities, as defined in Section 2(a)(1) of the Securities Act as part of its statutory general account reserves as mandated by Maryland insurance law.

At a minimum, OM Financial Life Insurance Company of necessity must calculate amounts it will actually pay under each of its general account annuities and life insurance policies having a cash value—not just its indexed annuities—in whole or in part, by reference to the performance of a security, including a group or index of securities it holds as part of its statutory reserves for these contracts, thus satisfying the first part of the new test in Proposed Rule 151A(a)(1).

Depending on how broadly the Commission or a court subsequently interprets “amounts payable” in proposed Rule 151A(a)(1), the proposed rule may reach a variety of other contracts, such as long term care insurance policies that have cash values. This test may also extend to features of contracts that do not have cash values, but have current pricing elements that deliver

“performance” that is better than the guaranteed maximum pricing, for example, current non-guaranteed premiums on indeterminate premium term life insurance policies.<sup>47</sup>

## **B. Indexed Annuity Contracts Fall Within the Section 3(a)(8) Exemption**

The text of Section 3(a)(8) does not support the test set forth in proposed rule 151A(a)(1). Section 3(a)(8) exempts from the registration requirements of the 1933 Act:

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

Indexed annuities are annuity contracts issued by insurance corporations that are subject to the supervision of state insurance regulators. This supervision includes traditional solvency regulation as well as state insurance disclosure and sales practice regulation. This supervision has been continuous since indexed annuities were first introduced in the mid-1990’s.

In VALIC, the Court observed its:

reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements. When the States speak in the field of ‘insurance,’ they speak with the authority of a long tradition. For the regulation of ‘insurance’ though within the ambit of federal power [citation omitted], has traditionally been under the control of the States.<sup>48</sup>

Indexed annuities are annuities within the plain meaning of the statute. Congress has not acted to repeal this statute. Similarly, Congress has not acted to repeal the McCarran-Ferguson Act under which Congress left the business of regulating insurance to the states. As discussed above, the states have uniformly regarded indexed annuities as part of the business of insurance since they were first introduced in the mid-1990’s and have regulated these contracts as traditional deferred annuity contracts are regulated under those laws—laws that are “in actual effect.” In proposing rule 151A, the SEC takes a position inherently inconsistent with the U.S. Supreme Court’s reluctance in VALIC “to disturb the state regulatory schemes that are in actual effect.” In doing so the SEC proposes a rule so broad that it effectively repeals Section 3(a)(8) for an ill-defined class of contracts much broader than indexed annuities.

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<sup>47</sup> In an indeterminate premium term policy, the premium may fluctuate between the current charge and a maximum amount stated in the insurer's premium tables, which are based on the insurer's mortality experience, expenses, and investment returns. See <http://www.finweb.com/insurance/types-of-term-policies.html>

<sup>48</sup> 359 U.S. 65, 68-69.

### **III. THE TEST IN PROPOSED RULE 151A(A)(2) IS OVERLY BROAD AND MEANINGLESS WHEN ONLY ONE OUTCOME IS POSSIBLE**

Since any general account product that credits interest over and above guaranteed minimums must necessarily do so by reference to the performance of securities held as part of the insurer's general account reserves, nearly every product that is subject to the test will be a security. In fact, it is difficult to conceive of any saleable product that potentially credits excess interest that would not be a security. As such, the "test" is not a pass-fail test. It is a fail-only test. As a practical matter, a test with only one outcome is a meaningless test and could just as easily be restated as "any product that potentially credits nonguaranteed interest is a security."

### **IV. THE TEST IN PROPOSED RULE 151A(A)(2) IS CONTRARY TO AND INCONSISTENT WITH SECTION 3(A)(8) AND GUIDING PRECEDENT CITED IN THE PROPOSING RELEASE**

Proposed rule 151A incorporates a new test that is neither derived from nor supported by Section 3(a)(8) or the U.S. Supreme Court decisions interpreting the scope of Section 3(a)(8) cited in the Proposing Release. Stated differently, the new test—which essentially defines investment risk as the risk the contractowner will receive less excess indexed interest than hoped for over and above the minimum guaranteed rate of interest established by the applicable state nonforfeiture law—is contrary to Section 3(a)(8) and guiding precedent cited in the Proposing Release. The new test completely ignores the fact that indexed annuities protect contractowners against the *very* risks implicating the need for federal securities law protections in VALIC and United Benefit.

#### **A. Proposed Rule 151A Fails to Evaluate State Regulated Guarantees**

##### **1. VALIC**

In VALIC, the Supreme Court held that the variable annuity at issue was not an "annuity" within the meaning of Section 3(a)(8) because the entire investment risk was borne by the annuitant, not the insurance company. The variable annuity guaranteed "nothing to the annuitant except an interest in a portfolio of common stocks or other equities—an interest that has a ceiling but no floor."<sup>49</sup>

The key investment characteristic that caused the annuity at issue in VALIC to fall outside the scope of Section 3(a)(8) was that the insurer provided *no* guarantee of principal and interest. The Supreme Court contrasted the variable annuity at issue in VALIC with traditional insurance contracts, noting that the "common understanding of "insurance" involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts."<sup>50</sup> The Court also noted that "companies that issue these [general account] annuities take the risk of failure"<sup>51</sup> because an

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<sup>49</sup> 359 U.S. 65, 72.

<sup>50</sup> 359 U.S. 65, 71.

<sup>51</sup> *Id.*

insurer may not obtain a large enough return on the premiums it invests to meet its contractual guarantees.

Unlike the variable annuity contract examined by the Supreme Court in VALIC, insurers issuing non-registered indexed annuities today provide at least the guaranteed minimum values required by state nonforfeiture laws.<sup>52</sup> Thus, unlike a variable annuity, which contains no guarantee of principal and interest or guaranteed minimum values, there is always an insurance guarantee present in indexed annuities that “at least some fraction of the benefits will be payable in fixed amounts.” Indexed annuities have a significant floor which is established by state legislatures in regulating the business of insurance.

Old Mutual’s indexed annuities are not variable annuities. The annuitant has no interest in a portfolio of common stocks or other equities. The value and benefits offered under Old Mutual’s indexed annuities are independent of the investment experience of the insurance company’s general account. Assets supporting Old Mutual’s obligations under its indexed annuities are part of the insurance company general account—not a variable separate account—and as part of its statutory reserve, do not support any other general account liability to any greater or lesser extent.

In particular, Old Mutual’s indexed annuities provide the following guarantees:

- The guarantee of principal and all previously credited interest;

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<sup>52</sup> Indexed annuities comply with the same state standard nonforfeiture law that traditional fixed annuities comply with, as contrasted to registered indexed annuities that comply with a modified guaranteed annuity state regulation (contracts with certain market value adjustment (“MVA”) features) or variable annuities that pass the actual investment experience of a separate account through to contract holders and which are not subject to a state standard nonforfeiture law.

To paraphrase VALIC, state legislatures in regulating the business of insurance adopt nonforfeiture laws that determine “what fraction of the benefits will be payable in fixed amounts” under indexed annuity contracts. The Proposing Release recognizes the protection that state insurance law provides in regulating the financial condition of *insurers* in the context of proposed rule 12h-7. It fails to appropriately consider the equally important protection that state insurance law provides to *purchasers* of indexed deferred annuities—including those who choose for whatever reason to surrender their contracts while a surrender charge remains applicable.

From a product perspective, state insurance law addresses *insurer* solvency through a variety of laws including but not limited to:

- valuation laws which regulate reserves an insurer must hold by type of contract
- investment laws which specify permitted investments and investment concentration for general account products; and,
- risk-based capital requirements.

Obviously, these laws intended to protect insurer solvency indirectly protect *purchasers* of contracts by facilitating the likelihood that the insurer will be able to pay its contractual obligations when due. However, **state insurance law also directly protects purchasers by requiring insurers to provide certain minimum benefits to persons who surrender these contracts.** See Black and Skipper, *Life & Health Insurance*, 13<sup>th</sup> Ed. p. 754-756. “Concepts of Equity” (2000).

- The guarantee that an index credit will never be less than zero, in other words, there will be no negative interest;
- Guaranteed surrender charges that do not vary with the investment performance of the insurer's general account;
- Guaranteed surrender charges that do not vary with changes in market interest rates, in other words, Old Mutual's indexed annuities do not include MVA features of any kind;<sup>53</sup>
- Guaranteed surrender charges that do not reduce the surrender value below the minimum permitted values under state insurance nonforfeiture laws regulating the business of insurance;
- Guaranteed surrender charges that are fixed percentages established at contract issue and are contingent solely on when a surrender or early annuitization occurs during the surrender charge period;
- Guaranteed surrender charges that are unrelated to any change in the underlying indexes referenced by the interest crediting formulas in the contract;
- Guaranteed surrender values that are computed using a "specified rate of interest" as defined in Rule 151 and will always equal or exceed the minimum nonforfeiture amount required under state nonforfeiture laws regulating the business of insurance;
- A guaranteed death benefit before annuity payouts begin, paid without the assessment of surrender charges which might otherwise be lawfully imposed under state nonforfeiture laws regulating the business of insurance; and,
- Guaranteed annuity purchase rates on annuity payout options which include life contingent payments, which are established at contract issue and may not be changed by the insurer when longevity improves.

In contrast to the SEC's position that the guarantees provided by indexed annuities are not "substantial enough," these state regulated insurance guarantees assumed by the insurance company place all the investment risk on the insurance company and none on the annuitant. The insurance "companies that issue these annuities take the risk of failure."<sup>54</sup>

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<sup>53</sup> The cost to an insurer of foregoing an MVA has been estimated to be as much as 100 basis points annually:

"The 'two-tiered annuity,' where one interest rate is available to those policyholders who surrender in a lump sum, whereas a higher rate is available to those who receive their benefit in the form of an annuitization over several years, was developed to reward policyowners who do not subject the insurer to the "cost" of book value surrender. However, critics of this form of annuity argue that those who surrender in a lump sum are receiving an amount that is unfairly low, and that the buyer of such policies might be forced into receiving this lower value by an unexpected emergency.

While this criticism appears to have merit, it ignores the difference in costs to the insurer, which can be measured as the price of the option granted to the policyowner to receive the lump sum value without adjustment for market value losses of the assets backing such annuity. Such an option mandates that the insurer must invest portions of the funds received in shorter duration securities than it would invest in if such an option were not present. This option has been priced by some studies that indicate this "cost" to be as much as 100 basis points annually."

NAIC Proceedings 1993, Vol. IB, p. 1429

<sup>54</sup> 359 U.S. 65, 71.

## 2. United Benefit

In United Benefit, the Supreme Court held that the variable annuity at issue was not an “annuity” within the meaning of Section 3(a)(8) because the insurer promised “to serve as an investment agency and allow the policyholder to share in its investment experience” and while the insurer provided a guaranteed surrender value, it was “insignificant.”

In United Benefit, the Supreme Court analyzed a variable annuity under which the insurer invested the net premiums through a *separate account* established under Nebraska insurance law,<sup>55</sup> primarily in common stocks<sup>56</sup> and the contract owner bore the investment risk. In United Benefit the annuity at issue fell outside the scope of Section 3(a)(8) because the guarantee of principal was not meaningful.

At any time before maturity, the insurer provided a guaranteed surrender value under the contract equal to the greater of:

- her proportionate share of the fund; or
- a cash surrender value equal initially to 50% of net premiums in the first five years, increasing to 100% of net premiums after 10 years.<sup>57</sup>

Notably, United Benefit was not obligated to offer *any* guarantee in its variable annuity. Accordingly, under the Nebraska state insurance regulatory scheme governing insurance company *separate account* products, United Benefit was free to set the terms of the guarantee in its favor rather than the contract owner’s under most economic scenarios.<sup>58</sup>

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<sup>55</sup> Following the VALIC decision in 1959, state legislatures adopted laws authorizing life insurance companies to: (1) issue variable annuities; and, (2) establish separate accounts. A variable separate account is an asset account maintained independently from the insurer’s general investment account and is used primarily for retirement plans and variable products. This arrangement permits wider latitude in the choice of investments, particularly in equities. 2007 Life Insurers Fact Book, *supra*, note 18.

Section 2(a)(14) of the 1933 Act defines separate account as “an account established and maintained by an insurance company pursuant to the laws of any State or territory of the United States, the District of Columbia, or of Canada or any province thereof, under which income, gains and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.”

Purchase payments for a *general account* indexed annuity are not held in a variable separate account. The purchaser of an annuity issued by a variable separate account participates in the investment gains and losses of the separate account. In contrast, the assets of the general account belong to the insurance company. General account assets are used by the insurance company in support of the business it conducts, including the payment of guaranteed obligations it has assumed under the terms of the general account indexed annuities it issues. *The purchaser of a general account indexed annuity does not participate in the gains or losses of the general account of an insurer.*

<sup>56</sup> 387 U.S. 202, 205.

<sup>57</sup> *Id.*

<sup>58</sup> The record in United Benefit showed that “United set its guarantee by analyzing the performance of common stocks during the first half of the 20<sup>th</sup> century and adjusting the guarantee so that it would not become operable under any prior conditions.” 387 U.S. 202, 209.

The “guaranteed surrender value” in United Benefit’s variable annuity was not required by law; rather, it was apparently added to United Benefit’s variable annuity in an attempt to satisfy the assumption of investment risk requirement that the Supreme Court found lacking in VALIC.

**B. Proposed Rule 151A Fails to Evaluate Investment Risk Assumed by the Insurer**

Insurers issuing fixed annuities (both traditional and indexed) assume a variety of investment risks including:

- the risk that they will have insufficient funds to meet all contractual obligations.
- the risk of disintermediation. This is the risk that interest rates will rise and contract owners will exercise their right to surrender the contracts. To pay these surrender values, the insurer must sell assets, primarily bonds, from its general account at depressed market values, in which case the insurer may incur substantial losses well in excess of any surrender charges the insurer may collect. Some insurers have addressed this risk by shifting it to the contract owner through a registered MVA feature; Old Mutual’s indexed annuities do not include any MVA features, and Old Mutual retains one hundred percent of the disintermediation risk under its indexed annuities.
- reinvestment risk. This is the risk that as bonds in the insurer’s general account mature or coupons are paid, available bond returns are reduced to a level that will not support the guarantees embedded in the contract including the guarantees dictated by state nonforfeiture laws.

In addition to these risks, insurers issuing fixed indexed annuities face a variety of other investment risks related to the strategies they employ to hedge the risks they assume when they agree to pay interest based in part on changes in an external index they neither control nor manage:

- counterparty or credit risk. This is the risk that the hedge asset purchased to fund the indexed crediting strategy may not return the required amount needed to credit the contractually agreed upon rate of interest due to default of the issuing party. If this occurs, the insurer must still pay the calculated rate of interest due under the contract from its general account assets.
- the risk that the hedge program will return less than the amount needed to credit the contractually agreed upon rate of interest. This occurs frequently as insurers must make assumptions concerning persistency (how many contract owners will keep their contracts rather than surrender them) and strategy allocations (how contract owners may choose to allocate their contract value among various interest crediting options available under the contract)—with the timing of each of these events being determined solely by the contract owner without regard to, or knowledge of, the insurer’s general account assets which support its contractual obligations.

In each case, regardless of the results of any hedge strategy the insurer may employ, the insurer must credit interest as determined in accordance with the interest crediting formula in the contract. Under no circumstance may the insurer credit a lesser amount of interest because the

insurer's hedge strategy failed to produce the funds necessary to honor the insurer's contractual obligation. The insurer alone bears this risk.

The Proposing Release omits any discussion of these investment risks insurers assume when they issue indexed annuity contracts. Instead, proposed rule 151A's new test equates "investment risk" with indexed interest credited on the initial investment that exceeds the minimum guaranteed rate of interest established by the applicable state nonforfeiture law. This risk is not the type of investment risk the U.S. Supreme Court in VALIC defined as relevant in Section 3(a)(8) analysis.

### **C. Proposed Rule 151A Adopts an Incorrect Measure of Investment Risk**

The Proposing Release indicates annuity owners assume the investment risk under the contract when they are "more likely than not to receive payments that vary in accordance with the performance of a security."<sup>59</sup> Under proposed rule 151A(a)(2), this investment risk is present when "amounts payable" are more likely than not to exceed "amounts guaranteed."<sup>60</sup>

Proposed Rule 151A(a)(2) equates amounts of current interest<sup>61</sup> to be received by the contract owner under the terms of the index-linked interest crediting formula to investment risk assumed by the owner of an indexed annuity. But the risk of what the current interest rate will be is not an investment risk of the type indicative of a non-exempt security under Section 3(a)(8). It is fundamental to the business of insurance and exists in all contracts in which the insurer indicates it will (or may) credit a current interest rate that exceeds the state mandated minimum guaranteed rate of interest established by state legislatures in regulating the business of insurance.

The Proposing Release indicates the consumer "underwrites the effect of the underlying index's performance on his or her contract investment and assumes the majority of the investment risk for the equity-linked returns under the contract."<sup>62</sup> This statement confuses the uncertainty of not knowing what current interest rates the insurer will declare in the future with underwriting of investment risk. In every traditional fixed annuity the consumer bears the risk that the insurance company may not declare a current interest rate that exceeds the state mandated minimum guaranteed rate of interest.

The difference between "amounts payable" and "amounts guaranteed" is simply a measure of excess interest declared by an insurance company, not investment risk.<sup>63</sup> Historically, crediting

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<sup>59</sup> Proposing Release at 5.

<sup>60</sup> Proposed Rule 151A(a)(2).

<sup>61</sup> Note that the "more likely" standard indicates that *more* current interest indicates more consumer risk, which is inconsistent with the solvency point of view that the obligation to pay more current interest indicates more insurer risk.

<sup>62</sup> Proposing Release at 6.

<sup>63</sup> Under Subsection (b)(1) of Proposed Rule 151A surrender charges would also be included in this difference. Insofar as the Proposed Rule intends to deem a contract a security if it charges a contingent deferred sales charge, we would consider this preemptive of state regulation of insurance which establishes minimum contract surrender values for fixed annuities and therefore imposes maximum permissible surrender charges. In any event, we disagree in concept with a rule dictating when charges should be taken into account. If amounts payable at a point in time or

of excess interest has been indicative of insurance company risk taking, not risk taking by the annuity owner. Once a current interest rate is declared the insurance company is obligated to credit contract values at that interest rate regardless of whether its general account assets perform consistently with the declared rate of current interest.

The Rule 151 Proposing Release<sup>64</sup> distinguished the *frequency* of crediting of current interest from the *amount* of current interest to be credited and noted that the amount to be credited, although indicative of the amount of risk the insurer bears, is a solvency risk adequately addressed by state insurance regulation:

Of course, the degree of investment risk assumed by the insurer also is based on the *amount* of discretionary excess interest it guarantees. But that risk, *i.e.*, the risk that the insurer, by making imprudent investments or because of insolvency, will not be able to satisfy its contractual obligations, is the type of risk that Congress deemed to be adequately addressed by state insurance regulation. See VALIC, 359 U.S. at 77 (emphasis added).<sup>65</sup>

Similarly, to the extent any purchaser of an indexed annuity bears a risk of insurer insolvency there is adequate state regulation. The Proposing Release acknowledges in connection with the proposal of Rule 12h-7 that solvency risks are adequately addressed by state regulation: “[I]nvestors who purchase these securities are primarily affected by issues relating to the insurer’s financial ability to satisfy its contractual obligations—issues that are addressed by state law and regulation.”<sup>66</sup>

**D. Proposed Rule 151A Disregards Marketing as a Factor under Section 3(a)(8) And Therefore Is Inconsistent With Supreme Court And Other Judicial Precedent**

The Proposing Release acknowledges that “marketing is another significant factor in determining whether a state-regulated insurance contract is entitled to the Securities Act ‘annuity contract’ exemption”<sup>67</sup> and cites the applicable language from United Benefit.<sup>68</sup> The Proposing Release further states that the Commission analyzes “indexed annuities under the facts and circumstances factors articulated by the U.S. Supreme Court in VALIC and United Benefit.”<sup>69</sup> However, the Proposing Release fails to analyze the marketing of indexed annuities. Further, proposed rule

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upon happening of an event (surrender) are net of charges then charges should be taken into account, and if amounts guaranteed at a point in time or upon happening of an event (death) are not net of charges then charges should not be taken into account.

<sup>64</sup> Definition of ‘Annuity Contract or Optional Annuity Contract’, Rel. No. 33-6558 (Nov. 21, 1984)(proposing Rule 151).

<sup>65</sup> *Id.* at Note 18.

<sup>66</sup> Proposing Release at 7.

<sup>67</sup> Proposing Release at 19.

<sup>68</sup> *Id.*

<sup>69</sup> Proposing Release at 23.

151A does not incorporate a requirement that the class of contracts to be denied the exemption must, in accordance with United Benefit, be “marketed in a manner that appeals to the purchaser not on the usual basis of stability and security but on the prospect of ‘growth’ through sound investment management.” The omission of this factor from proposed rule 151A is startling given the emphasis the Proposing Release places on abusive sales practices.

In United Benefit the Supreme Court first articulated the “marketing test” for purposes of determining which contracts meet the requirements of Section 3(a)(8). The Supreme Court based its conclusion in part on the manner in which the variable annuities were advertised. The Supreme Court noted that United Benefit’s annuity, and others like it, were *not* promoted “on the usual insurance basis of stability and security but on the prospect of ‘growth’ through sound investment management.”<sup>70</sup> Such contracts were marketed to compete with mutual funds and were “pitched to the same consumer interest in growth through professionally managed investment.”<sup>71</sup>

The obligation not to market an indexed annuity primarily as an investment, however, does not preclude an insurer from discussing what may be considered to be the investment aspects of the contract. In Associates in Adolescent Psychiatry v. Home Life Insurance Company, the federal district court determined that the annuity contract was not marketed primarily as an investment just because isolated statements in the company’s sales literature referred to the investment aspects of the annuity contract.<sup>72</sup> 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.”<sup>73</sup>

This finding of the Home Life court was reiterated in the decision of the federal district court in Berent v. Kemper Corp.<sup>74</sup> In finding that the life insurance policies in question were marketed primarily as insurance, the court determined that “the facts that the sales brochures also discuss the investment features of the policies and that Plaintiffs...perceived the policies as investment

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<sup>70</sup> 387 U.S. 202.

<sup>71</sup> *Id.*

<sup>72</sup> 729 F. Supp 1162 (N.D. Ill., 1989); *aff’d*, 941 F.2d 561 (7<sup>th</sup> Cir.1991), *cert denied*, 502 U.S. 1099 (1992).

<sup>73</sup> *Id.* at 1174 (emphasis added).

<sup>74</sup> 780 F. Supp. 431 (E.D. Mich. 1991); *aff’d*, 973 F. 2d 1291 (6<sup>th</sup> Cir. 1992).

vehicles does not change...the conclusion that the...policies were not marketed primarily as investments.”<sup>75</sup>

More recently, the federal district court in Malone v. Addison Insurance Marketing, Inc.,<sup>76</sup> applying the United Benefit marketing test, analyzed a marketing brochure (that promised “stability and flexibility”), the contract form, and a disclosure form for an equity indexed annuity and found that the materials did not demonstrate the contract was marketed as an investment. Specifically, the Malone court said:

[M]aking reference to investments in the context of assuring the security of an annuitant’s premium, and an aggressive marketing strategy related to the potential for growing that premium have distinct legal significance....[The] Court must determine...if it appears the marketing emphasis was clearly more correlated to the prospect [of] growth in lieu of stability.

[The] brochure, though it mentions the company’s “sound financial management,” does so in the context of explaining that the company promises “stability and flexibility”.... In addition, the contract itself states plainly... “that past S&P 500 Index activity is not intended to predict future activity and that the S&P 500 Index does not include dividends”.... Moreover, the one-page summary Plaintiff signed, which focused on how her Contract Value was calculated at any one point to assure her the initial principal plus interest, did not emphasize the potential increase in her assets, but focused on explaining to her that she was guaranteed her principal plus three percent interest.<sup>77</sup>

The court concluded that the contract was exempt from the federal securities laws under Section 3(a)(8).<sup>78</sup>

The Commission has not promulgated rules prescribing acceptable or unacceptable marketing techniques for purposes of determining a product’s status under Section 3(a)(8). However, it has agreed with judicial determinations that references to investment features of a contract do not necessarily preclude a court from finding that the contract was not marketed primarily as an investment. When adopting the standard under Rule 151 that a contract not be marketed primarily as an investment, the Commission explained that

“[b]y adopting this standard...the SEC is not saying, nor has it ever said, that an insurer in marketing its product cannot describe the investment nature of the contract, including its interest rate sensitivity and tax-favored status... [A] marketing approach that fairly and accurately describes both the insurance and investment features of a particular contract, and that emphasizes the product’s

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<sup>75</sup> *Id.* at 443.

<sup>76</sup> 225 F. Supp. 2d 743 (W.D. Ky, 2002).

<sup>77</sup> *Id.* at 753-754.

<sup>78</sup> The Proposing Release is critical of Malone’s findings under Rule 151 but it does not criticize the court’s ruling under Section 3(a)(8).

usefulness as a long-term insurance device for retirement or income security purposes, would undoubtedly ‘pass’ the rule’s marketing test.”<sup>79</sup>

Old Mutual controls the content of its indexed annuity marketing materials to comport with these standards and the standards applicable to the advertising of these contracts under state insurance law. By not considering marketing as a factor, the proposed rule is inconsistent with Supreme Court and other judicial precedent.

#### **E. Proposed Rule 151A Disregards Mortality Risks as a Factor under Section 3(a)(8)**

Both judicial<sup>80</sup> and Commission interpretations recognize that mortality risk is an important consideration in determining whether annuity contracts come within the Section 3(a)(8) exclusion. In a general statement of policy issued on April 5, 1979, the Commission identified the assumption of mortality risks and investment risks as central features of life insurance or annuity contracts.<sup>81</sup> In the release adopting Rule 151, however, the Commission withdrew Release 6051 and abandoned this requirement for purposes of the safe harbor. Nevertheless, the Commission continued to express the view that mortality risk may be an appropriate factor to consider determining the availability of an exemption from Section 3(a)(8).<sup>82</sup>

Old Mutual’s indexed annuities provide a death benefit before annuity payouts begin. This death benefit is significant in that interest is calculated under the indexing formula until the death benefit is calculated. This contrasts with the general contract surrender value under which no indexed interest is credited to amounts surrendered during an indexing period.

In addition, although not required to do so under applicable state nonforfeiture law, when Old Mutual pays the death benefit under an indexed annuity, it waives any remaining surrender charge. Because Old Mutual waives surrender charges when it pays a death benefit under its indexed annuities, the value of the death benefit may be even greater to seniors than it is to younger retirement savers. In any event, Old Mutual assumes a significant traditional insurance mortality risk in providing this benefit that proposed rule 151A fails to consider.

In addition to assuming the mortality risks associated with the death benefit Old Mutual provides under its indexed annuities, Old Mutual assumes other significant mortality risks under its

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<sup>79</sup> Release 6645 at 13.

<sup>80</sup> *Grainger v. State Security Life Insurance Co.*, 547 F.2d 303, 307 (5<sup>th</sup> Cir. 1977)(considering the relationship between the size of the death benefit and the size of premium payments as part of the court’s Section 3(a)(8) analysis), *reh’g. denied*, 563 F.2d 215 (5<sup>th</sup> Cir. 1977), cert. denied sub nom. *Nimmo v. Grainger*, 436 U.S. 932 (1978); *Dryden v. Sun Life Assurance Co. of Canada*, 737 F. Supp. 1058 (S.D. Ind. 1989)(concluding that the insurer’s obligation to pay a fixed sum to a designated beneficiary upon the death of the owner of a life insurance policy caused the insurer to bear the risk of poor performance of its investments).

<sup>81</sup> Statement of Policy Regarding the Determination of the Status Under the Federal Securities Laws of Certain Contracts Issued by Insurance Companies, Rel. No. 33-6051 (Apr. 5, 1979)(hereinafter referred to as “Release 6051”).

<sup>82</sup> *See, e.g.*, Brief for the United States as Amicus Curiae at 9, *Variable Annuity Life Insurance Co. v. Otto*, No 87-600 (1988).

indexed annuities in connection with annuity payment options it provides based on life contingencies. By currently guaranteeing life annuity options that can be selected at some future time, Old Mutual assumes a mortality risk that the longevity of its annuitants may be greater than it assumed when it issued the contract.

**V. PROPOSED RULE 151A WILL HAVE THE UNINTENDED CONSEQUENCE OF REDUCING LONG TERM VALUE TO CONSUMERS INTERESTED IN GUARANTEED GENERAL ACCOUNT PRODUCTS**

About 77 million baby boomers are expected to retire over the next few years. Many of these retirees will not have a source of guaranteed monthly income for their lifetime apart from Social Security benefits. A recent study commissioned by Americans for Secure Retirement, a coalition of more than 50 organizations representing women's, small business, agricultural, Hispanic and African American groups concluded that retirees would be much better prepared if they had a guaranteed source of retirement income beyond Social Security.<sup>83</sup>

Annuities are insurance contracts that pay a steady stream of income for either a fixed period of time or for the lifetime of the annuity owner, in addition to providing a number of other important guarantees. Because they guarantee a stream of income for life, annuities protect senior consumers against the real and growing possibility of outliving their financial resources due to factors such as increased longevity, rising health care costs, declining investment markets and reductions in Social Security benefits.

Consumers saving for retirement benefit when they have a variety of registered and non-registered products from which to choose. Consumers who have selected indexed annuities over variable annuities, mutual funds or other securities for some portion of their retirement savings have generally done so to obtain stable income, a guarantee of principal and interest that has been credited to the contract, and the other guarantees that indexed annuities provide.

**A. Additional Costs of Issuing Registered Products will Be Passed Through to Consumers**

Insurance companies issuing registered indexed annuities will incur additional one-time and permanent additional costs. Many of these costs are noted in the Proposing Release, such as costs of performing the required test, cost of registering products,<sup>84</sup> cost of printing prospectuses and mailing them to investors, costs of life insurance agents entering into networking arrangements with broker-dealers, and loss of revenue.

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<sup>83</sup> Nancy Treos, "Many Retirees Face Prospect of Outliving Savings, Study Says" The Washington Post, July 13, 2008.

<sup>84</sup> The Proposing Release estimates aggregate annual costs of \$82,500,000 assuming 400 contracts each year will be filed on Form S-1. This works out to a per contract cost of \$206,500 for preparing and filing registration statements for indexed annuities. Using this figure, it will cost Old Mutual in excess of \$4,500,000 to file the 22 indexed annuities it currently offers. This figure does not include prospectus print and mailing costs or the cost of hiring independent actuarial consultants to develop or validate the company's testing procedures.

Costs not noted may include:

- costs related to due diligence undertaken by professionals and required in connection with the preparation and filing of a registration statement on Form S-1;<sup>85</sup>
- costs to design, develop and maintain new recordkeeping systems required in connection with registered products;<sup>86</sup>
- costs of destroying existing inventories of marketing materials;
- costs of preparing and filing new advertising materials<sup>87</sup> with FINRA;
- costs of administering registered products in excess of the costs of administering non-registered products;
- costs related to increased audit expenses, including the need to inform independent auditors about the companies' controls, procedures and assumptions related to its registered contract business operations;
- costs to build or modify systems due to direct requirements of the proposed rule (e.g., to provide prospectuses and confirms) or indirect consequences of the proposed rule (e.g., possible product design revisions);
- costs associated with negotiating and preparing selling agreements between the insurance company, its principal underwriter and registered broker-dealers;<sup>88</sup>
- costs associated with staffing reductions including in some cases, costs of compliance with "plant closing" laws for insurers downsizing or exiting altogether;
- costs of staffing additions and staffing replacements as new needs are determined, for example, adding wholesalers by firms that do not currently distribute their product through broker-dealers;
- costs arising from increased litigation expense and professional witness fees; and
- costs attributable to increased insurance and bonding expense.

These costs would necessarily be passed through to the consumer in the form of lower guarantees, lower credited interest rates, higher surrender charges, higher optional feature charges or other product design modifications. Additional costs to the consumer will necessarily

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<sup>85</sup> The Proposing Release at 76 mentions only the costs of preparing and reviewing disclosure; it does not address the costs of professional due diligence examination required in connection with the preparation of a registration statement on Form S-1.

<sup>86</sup> The Proposing Release at 76 mentions only the cost of retaining records. For companies that do not currently issue registered contracts these costs may be significant.

<sup>87</sup> Note, however, in the absence the SEC's adoption of a rule for indexed annuities comparable to Rule 482, the SEC adversely and unfairly burdens the marketing of indexed annuities vis-a-vis variable annuities and mutual funds.

<sup>88</sup> This cost will be greater for insurers who currently lack a variable contract or mutual fund distribution platform. The Proposing Release at 75 and 77-78 mentions only the cost of entering into networking agreements which applies to distributors, not insurers.

result in lower long term retirement value to consumers which is not a desirable outcome given the current retirement crisis in America.

**B. Proposed Rule 151A Will Have the Effect of Decreasing Competition and/or Product Availability**

Because indexed annuities are currently regulated as insurance, the Commission is well aware of the fact that insurance agents unaffiliated with broker-dealers are the primary distributors of indexed annuities today. We expect some of these insurance licensed only providers will become affiliated with broker-dealers as an associated person. We expect far more will not do so. Purchasers of indexed annuities currently can choose among providers: the purchaser can select an insurance licensed only provider, or may choose an insurance licensed provider who is also an associated person of a registered broker-dealer. Proposed rule 151A will eliminate the first choice entirely.

In view of the costs associated with registered products, we expect some insurers will simply stop selling these contracts altogether, and as a result, will lose significant revenues. In some cases, if an insurer can not find other revenue sources, it may need to merge with another company or cease doing business altogether.

On the other hand, insurers who choose to offer non-registered contracts following adoption of Rule 151A will need to design their contracts so that the indexing formula more often than not returns no more than the applicable state nonforfeiture guaranteed rate of interest. Insurers offering such contracts may find that those contracts are uncompetitive with other alternative long term savings vehicles in many, if not most, interest rate environments.

The effect of the adoption of Rule 151A clearly will be to reduce consumer choice and increase the costs of owning an indexed annuity contract.

**C. Registration of Products Will Have the Effect of Reducing Guarantees In Products and/or Transferring Greater Investment Risk to Consumers**

Indexed annuities already registered with the Commission,<sup>89</sup> because of the MVA feature contained in these contracts, may not guarantee minimum interest rates or may provide guaranteed minimum values that are less than what those values would be if they were computed under the standard nonforfeiture laws applicable to indexed annuities.<sup>90</sup>

In view of the significant cost to insurers of providing the guarantees required by the standard nonforfeiture law for individual deferred annuities applicable to indexed annuities, we believe it is reasonable to conclude that some insurers will simply file the product with the Commission as a separate account variable annuity on Form N-4, utilizing index funds as the underlying

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<sup>89</sup> See Proposing Release at Note 17 and accompanying text.

<sup>90</sup> Nonforfeiture values for annuities with MVA features are not determined under the standard nonforfeiture law for individual deferred annuities that applies to indexed annuities; rather, nonforfeiture values for MVA contracts are set under a separate regulation.

investment option, and by doing so, eliminate the requirement to provide any of the guarantees now found in non-registered indexed annuities.

Other insurers may find ways to shift additional risk to the purchaser of a registered indexed annuity. For example, rather than guarantee no negative interest, perhaps an insurer will guarantee that no more than 1% negative interest will be credited during the applicable crediting period. Other insurers may reduce the interest crediting period from at least 12 months to something less.

The clear result would appear to be that the costs of owning an indexed annuity contract would increase.

\* \* \*

Old Mutual appreciates the opportunity to provide comments on this proposal. In accordance with the Proposing Release at 2, we are filing this paper comment in triplicate with the Commission's Acting Secretary. On August 1, 2008, Old Mutual filed a formal request with the Commission in this rulemaking proceeding to extend the comment period to January 8, 2009 to permit its company management to ascertain the precise impact of the proposal. We believe the proposed rule deserves more analysis than the current comment period has permitted, especially since it potentially requires registration with the Commission of a number of insurance products offered today by insurers that do not offer indexed annuities and who are likely unaware of the need to analyze the impact of the proposed rule on their contracts. In any event, we respectfully reserve the right to supplement our comments herein with the Commission should it elect to extend the comment period. If you have any questions about our comments or would like any additional information, please contact me at (410) 895-0082.

Sincerely,

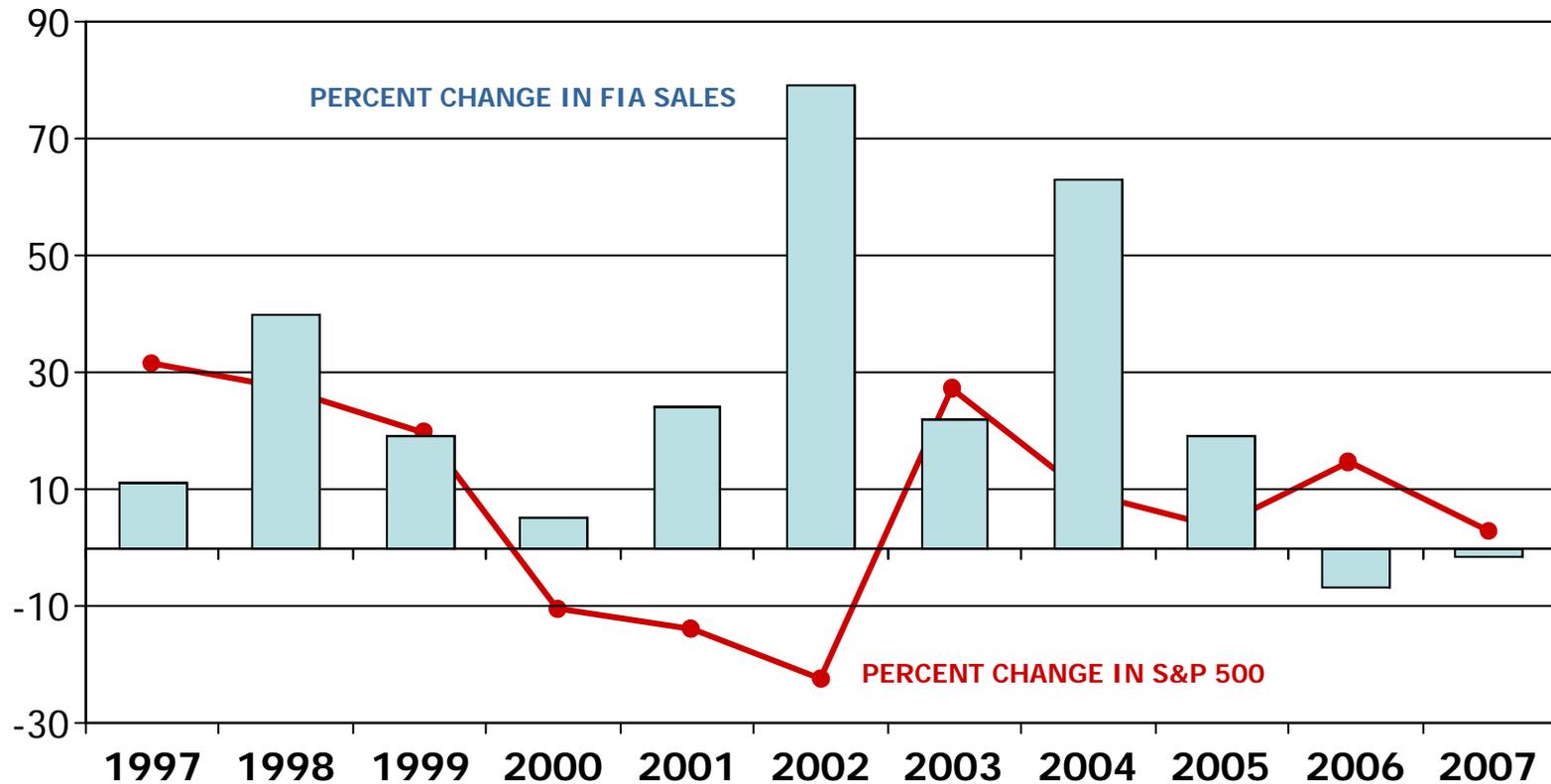


Eric Marhoun  
Senior Vice President & General Counsel

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

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

# When markets are down, FIA sales tend to go up (people seek protection for their money)





Dear OM Financial Life Insurance Company Customer:

We appreciate your recent purchase and would like to take this opportunity to assure you of our commitment to serving the needs of customers such as yourself. You can help us do a better job of service by telling us why and how you recently decided to purchase an Annuity product from OM Financial Life Insurance Company.

Please take a moment to complete this brief questionnaire, place it in the enclosed business reply envelope, and drop it in the mail — no stamp is required. We have asked LIMRA, an independent research organization, to conduct this survey for us.

If you have any questions about your purchase or if we can provide any other assistance, please contact your agent or our customer service department at 1-888-513-8797.

Cordially,

Bruce G. Parker Jr.  
 President  
 Old Mutual Financial Life Insurance Company

1. Based on your recent experience, how helpful was:

	<u>Extremely</u>	<u>Very</u>	<u>Somewhat</u>	<u>Not Very</u>	<u>Not at All</u>
a. The service provided by the agent?	<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	<input type="checkbox"/> <sub>3</sub>	<input type="checkbox"/> <sub>4</sub>	<input type="checkbox"/> <sub>5</sub>
b. Our product descriptions and sales materials?	<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	<input type="checkbox"/> <sub>3</sub>	<input type="checkbox"/> <sub>4</sub>	<input type="checkbox"/> <sub>5</sub>

2. What product(s) have you recently purchased from our company? (Mark all that apply.)

<u>Yes</u>	<u>No</u>	
<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	Annuities
<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	Life insurance
<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	Some other type of insurance

(If you did not buy an annuity, please skip to Question 7.)

3. Please indicate which of the following apply to the annuity you purchased by checking "yes," "no," or "not sure" for each feature listed. (Please answer for every feature listed.) Then ✓ which features were very important in your purchase decision.

<u>Annuity Features/Benefits</u>	<u>Yes</u>	<u>No</u>	<u>Not Sure</u>	<u>Very Important</u>
a. It provides tax-deferred savings.	<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	<input type="checkbox"/> <sub>3</sub>	<input type="checkbox"/>
b. Surrender charges are imposed on premature full withdrawal.	<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	<input type="checkbox"/> <sub>3</sub>	<input type="checkbox"/>
c. There may be tax penalties on any withdrawals prior to age 59½.	<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	<input type="checkbox"/> <sub>3</sub>	<input type="checkbox"/>
d. I understand that this product is not life insurance.	<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	<input type="checkbox"/> <sub>3</sub>	<input type="checkbox"/>
e. It can provide an income stream at retirement.	<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	<input type="checkbox"/> <sub>3</sub>	<input type="checkbox"/>
f. The interest I earn on this product is linked to performance indices (such as S&P 500) and is not the result of direct investment in the stock market.	<input type="checkbox"/> <sub>1</sub>	<input type="checkbox"/> <sub>2</sub>	<input type="checkbox"/> <sub>3</sub>	<input type="checkbox"/>

4. What sources of money are you using/did you use to pay for the annuity you recently purchased? (Mark all that apply.)

<input type="checkbox"/> Current income	<input type="checkbox"/> Rollover of money from a pension or retirement plan
<input type="checkbox"/> Savings (savings account or Certificate of Deposit (CD))	<input type="checkbox"/> Money from another annuity
<input type="checkbox"/> Investments (mutual funds, stocks, bonds, etc.)	<input type="checkbox"/> Money from a life insurance policy
<input type="checkbox"/> Inheritance or death benefit proceeds	<input type="checkbox"/> Other

5. a. Did your agent review your financial status, tax status, investment objectives, and other pertinent information to determine whether this annuity purchase is suitable for you at this time? <sub>1</sub> Yes <sub>2</sub> No

b. If no: Was a review offered? <sub>1</sub> Yes <sub>2</sub> No

6. How long do you plan to keep this annuity?

<sub>1</sub> 1–3 years    <sub>2</sub> 4–7 years    <sub>3</sub> 8–10 years    <sub>4</sub> More than 10 years

7. Do you have any suggestions about how we could improve service to you — or any additional comments?

\_\_\_\_\_

\_\_\_\_\_

Date completed \_\_\_\_\_



# Customer Assurance Program Activity Report

Form: A0463

Company Name: OM Financial

Reporting  
Month: September 2008

## Mail and Response Summary

Responses received in a given month are generally from earlier mailings. A mailing must be out for eight weeks before most responses are received. A few policyowners will be even slower in responding; a few will be early sending the form back immediately. This means that any response rate directly calculated from the mailing table below will be understated.

	<u>Reporting Month</u>	<u>Rolling-12</u>
Number of surveys mailed	486	9,785
Number of surveys returned	107	2,461
Undeliverables	7	87

## Response Rate

A response rate is calculated on a lag basis. An accurate estimate of a "true" response rate for your company and an average for all companies is shown below for mailings sent three calendar months ago. If the response rate for this form is not shown, either no file was mailed in the month or the mailing was too small to calculate a valid response rate.

	<u>July</u>
OM Financial	22.4 %
All companies	28.2



## Closed Confirmed Consumer Complaints by Coverage Type As of June 23, 2008

Data reflected in this report is voluntarily submitted to the NAIC proprietary Complaints Database System (CDS) by state insurance departments. Not all states provide all of their complaint data to the NAIC. Aggregate report data retrieved is specific only to risk bearing entities within the database and does not include information on specific agents/brokers. Complaints retrieved are those states deem confirmed. The NAIC does not guarantee the truth, accuracy, quality or completeness of the data and is not responsible for errors, omissions or for results of further use.

**Report Description:** The Closed Confirmed Consumer Complaints by Coverage Type report provides counts and percentages of the types of insurance coverages. The Summary of Coverage Counts section provides count summaries for the seven insurance coverage types and percentages of total counts. The Detail of Coverage Counts section provides counts for the first and second level coverage codes for each insurance coverage type from the NAIC's Complaint Database System. The data codes identified are based on the NAIC Standard Complaint Data Form.

A **Closed Complaint** is a complaint that has been investigated by the state insurance department, and given a resolution code.

A **Confirmed Complaint** is a complaint for which the state insurance department upheld the consumer's complaint position. Confirmed Complaints do not include those complaints in which all the complaint resolution codes used by the state, also known as the "complaint disposition," did not uphold the consumer's complaint position. Complaint resolution codes that do not uphold a consumer's complaint position are as follows: (1) Unable to assist; (2) Cancellation Upheld; (3) Nonrenewal Upheld; (4) No Action Requested/Required; (5) Handling Was Satisfactory; (6) Referred to Proper Agency/Section; (7) Company In Compliance; (8) Company Position Upheld; (9) No Jurisdiction; or (10) Insufficient Information.

### Summary of Coverage Counts

Type of Coverage	2008		2007		2006		2005	
	Count	% of Total	Count	% of Total	Count	% of Total	Count	% of Total
Auto	30,042	37.24%	75,720	37.05%	78,365	37.67%	83,510	39.84%
Accident & Health	30,380	37.66%	76,554	37.46%	67,944	32.66%	73,554	35.09%
Homeowners	8,883	11.01%	24,052	11.77%	36,026	17.32%	27,519	13.13%
Life & Annuity	7,560	9.37%	18,794	9.20%	16,255	7.81%	15,725	7.50%
Miscellaneous	1,673	2.07%	3,569	1.75%	3,346	1.61%	3,135	1.50%
Fire, Allied Lines & Commercial Multi-Peril	1,364	1.69%	3,733	1.83%	3,957	1.90%	3,682	1.76%
Liability	771	0.96%	1,943	0.95%	2,127	1.02%	2,467	1.18%
<b>Total</b>	<b>80,673</b>		<b>204,365</b>		<b>208,020</b>		<b>209,592</b>	

The percentages may not total 100% because each Type of Coverage % of Total is rounded to the 2nd decimal place.

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Report reflects data reported from the state insurance departments to the NAIC as of 06/23/2008.



**Closed Confirmed Consumer Complaints by Coverage Type**  
As of June 23, 2008

**Detail of Coverage Counts**

Code	Coverage Type		2008	2007	2006	2005
105	Auto	Private Passenger	17,002	42,100	40,961	46,726
107	Auto	Group Private Passenger	38	34	50	56
110	Auto	Commercial	895	2,117	2,355	2,702
115	Auto	Motorcycle	97	321	319	352
120	Auto	Motorhome	45	141	151	167
123	Auto	Motorsport	8	16	23	20
124	Auto	Rental	9	33	25	20
125	Auto	Other	81	339	2,411	1,167
130	Auto	Liability	6,606	17,182	17,741	19,355
135	Auto	Physical Damage	1,642	4,399	5,004	4,585
137	Auto	Collision	1,136	2,740	3,598	2,621
138	Auto	Comprehensive	518	1,174	1,106	1,167
140	Auto	Medical Payments	227	457	511	553
145	Auto	UM/UIM	207	552	506	510
150	Auto	No-Fault/PIP	485	1,280	1,027	1,135
151	Auto	Personal Effects Coverage	5	13	5	6
152	Auto	Policy Proof of Interest	2	3	4	8
153	Auto	Rental Reimbursement	156	331	282	221
154	Auto	Towing	17	55	51	46
155	Auto	JUA Related	9	25	35	38
156	Auto	Physical Damage Waiver	3	5	11	3
157	Auto	Collision Damage Waiver	4	13	14	8
158	Auto	Supplemental Liability	13	41	51	25
159	Auto	Personal Passenger	229	377	397	187
160	Auto	Other	608	1,972	1,727	1,832
205	Fire, Allied Lines & Commercial Multi-Peril	Fire, Allied Lines	51	172	136	200
207	Fire, Allied Lines & Commercial Multi-Peril	Crop/Hail	1	6	6	5
210	Fire, Allied Lines & Commercial Multi-Peril	Commercial Multi-Peril	577	1,457	1,699	1,650
215	Fire, Allied Lines & Commercial Multi-Peril	Credit Property	9	14	16	17
217	Fire, Allied Lines & Commercial Multi-Peril	Dwelling Fire	149	422	320	288
218	Fire, Allied Lines & Commercial Multi-Peril	Builder's Risk	10	30	35	24
220	Fire, Allied Lines & Commercial Multi-Peril	Other	117	315	92	79
225	Fire, Allied Lines & Commercial Multi-Peril	Liability	213	529	452	376
230	Fire, Allied Lines & Commercial Multi-Peril	Theft	29	56	197	123
233	Fire, Allied Lines & Commercial Multi-Peril	Windstorm	17	61	49	42
235	Fire, Allied Lines & Commercial Multi-Peril	Fire - Real Property	66	201	404	322
240	Fire, Allied Lines & Commercial Multi-Peril	Personal Property	18	48	105	80
243	Fire, Allied Lines & Commercial Multi-Peril	Residual Mkt./JUA Related	7	15	10	19
245	Fire, Allied Lines & Commercial Multi-Peril	Other	100	407	436	457

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Report reflects data reported from the state insurance departments to the NAIC as of 06/23/2008.



**Closed Confirmed Consumer Complaints by Coverage Type**  
As of June 23, 2008

**Detail of Coverage Counts**

Code	Coverage Type		2008	2007	2006	2005
305	Homeowners	Homeowners	5,576	14,771	15,183	13,322
307	Homeowners	Group Homeowners	10	23	22	15
310	Homeowners	Farmowner/Ranchowner	61	161	186	191
315	Homeowners	Mobile Homeowner	215	673	650	647
317	Homeowners	Condo/Town	188	581	245	359
318	Homeowners	Renters/Tenants	145	268	253	288
320	Homeowners	Other	129	452	294	243
325	Homeowners	Liability	257	713	4,842	2,820
330	Homeowners	Theft	146	422	4,566	2,561
333	Homeowners	Earthquake	4	30	7	12
334	Homeowners	Flood	62	174	187	180
335	Homeowners	Fire - Real Property	778	1,705	1,606	1,651
336	Homeowners	Single Interest	2	1	4	13
337	Homeowners	Medical Payments	7	16	17	14
340	Homeowners	Personal Property	240	691	4,850	2,820
341	Homeowners	Residual Mkt./JUA Related	6	8	4	2
342	Homeowners	Replacement Cost	61	149	153	156
343	Homeowners	Loss of Use	54	136	113	91
344	Homeowners	Windstorm	221	704	673	348
345	Homeowners	Other	721	2,374	2,171	1,786
405	Life & Annuity	Individual Life	3,392	8,184	6,723	7,061
410	Life & Annuity	Group Life	356	887	906	970
415	Life & Annuity	Annuities	857	2,284	2,166	1,619
417	Life & Annuity	Group Annuities	36	65	96	60
420	Life & Annuity	Credit Life	71	161	164	178
425	Life & Annuity	Accelerated Benefits	0	4	4	2
430	Life & Annuity	Other	127	325	506	298
435	Life & Annuity	Accidental Death & Dismemberment	77	216	153	144
440	Life & Annuity	Association	3	4	6	10
445	Life & Annuity	Equity Indexed	72	248	231	105
450	Life & Annuity	Fixed	151	388	438	300
455	Life & Annuity	Premium Waiver	11	25	30	28
460	Life & Annuity	Single Premium	103	247	218	206
465	Life & Annuity	Term	423	1,146	867	832
470	Life & Annuity	Universal	404	988	784	795
475	Life & Annuity	Variable	154	345	353	351
480	Life & Annuity	Whole	980	2,617	2,194	2,221
495	Life & Annuity	Other	343	660	416	545

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Report reflects data reported from the state insurance departments to the NAIC as of 06/23/2008.



**Closed Confirmed Consumer Complaints by Coverage Type**  
As of June 23, 2008

**Detail of Coverage Counts**

Code	Coverage Type	2008	2007	2006	2005
505	Accident & Health Individual	5,787	13,746	11,635	11,513
510	Accident & Health Group	10,648	26,281	22,306	27,881
515	Accident & Health Credit	128	273	286	353
517	Accident & Health Other	1,181	3,314	3,184	2,204
520	Accident & Health Accident Only	148	384	1,340	779
525	Accident & Health Disability Income	991	2,228	2,149	2,492
530	Accident & Health Health Only	4,954	12,549	11,952	13,584
535	Accident & Health Medicare Supplement	617	1,614	1,359	1,139
536	Accident & Health Medicare Select	234	653	217	81
540	Accident & Health Long-Term Care	851	1,777	1,700	1,926
541	Accident & Health Home Health Care	45	91	88	126
543	Accident & Health Mental Health	47	154	151	148
545	Accident & Health Dental	706	1,811	1,416	1,558
546	Accident & Health Occupational Accident	4	7	5	6
547	Accident & Health Limited Benefits	59	163	159	138
548	Accident & Health Chiropractic	20	60	61	39
549	Accident & Health Medicare Risk	108	416	235	98
550	Accident & Health Hospital Indemnity	125	258	180	282
551	Accident & Health Vision	27	56	35	52
552	Accident & Health HIPAA	22	42	53	41
553	Accident & Health Unemployment	1	2	8	11
554	Accident & Health Pre-existing Condition	25	41	51	52
555	Accident & Health Cancer/Dread Disease	260	617	588	640
556	Accident & Health Self Funded/ERISA	410	933	684	605
557	Accident & Health COBRA	66	157	158	160
558	Accident & Health HMO	921	2,948	2,579	3,111
559	Accident & Health PPO	561	1,808	1,493	1,534
560	Accident & Health Other	1,434	4,171	3,872	3,001

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Report reflects data reported from the state insurance departments to the NAIC as of 06/23/2008.



**Closed Confirmed Consumer Complaints by Coverage Type**  
As of June 23, 2008

**Detail of Coverage Counts**

Code	Coverage Type		2008	2007	2006	2005
605	Liability	General	477	1,055	1,218	1,399
610	Liability	Products	9	35	15	16
615	Liability	Professional E & O	40	105	102	178
617	Liability	Umbrella	24	95	78	108
618	Liability	Directors & Officers	2	7	2	8
620	Liability	Other	50	161	209	184
625	Liability	Employment Policy	0	9	7	5
630	Liability	Excess Loss	5	31	31	34
635	Liability	Medical Malpractice	14	51	55	78
640	Liability	Pollution	3	4	6	7
695	Liability	Other	147	390	404	450
705	Miscellaneous	Workers Compensation	645	1,121	1,338	1,397
710	Miscellaneous	Fidelity & Surety	83	234	193	252
715	Miscellaneous	Ocean Marine	21	33	47	39
720	Miscellaneous	Inland Marine	43	134	137	153
725	Miscellaneous	Title	130	316	331	242
727	Miscellaneous	In Home/Incidental Business	1	3	4	1
730	Miscellaneous	Mortgage Guaranty	2	10	13	4
733	Miscellaneous	Boiler Machinery	1	5	3	4
734	Miscellaneous	PMI	1	0	1	2
736	Miscellaneous	Surplus Lines	11	38	34	23
737	Miscellaneous	Watercraft	33	128	82	65
738	Miscellaneous	Aircraft	0	1	2	2
739	Miscellaneous	Bail Bonds	38	66	59	46
740	Miscellaneous	Warranty Contract	87	212	194	226
741	Miscellaneous	Federal Programs	179	411	100	35
742	Miscellaneous	Federal Crop	4	5	11	12
743	Miscellaneous	Federal Flood	34	87	45	76
745	Miscellaneous	Other	360	765	752	556

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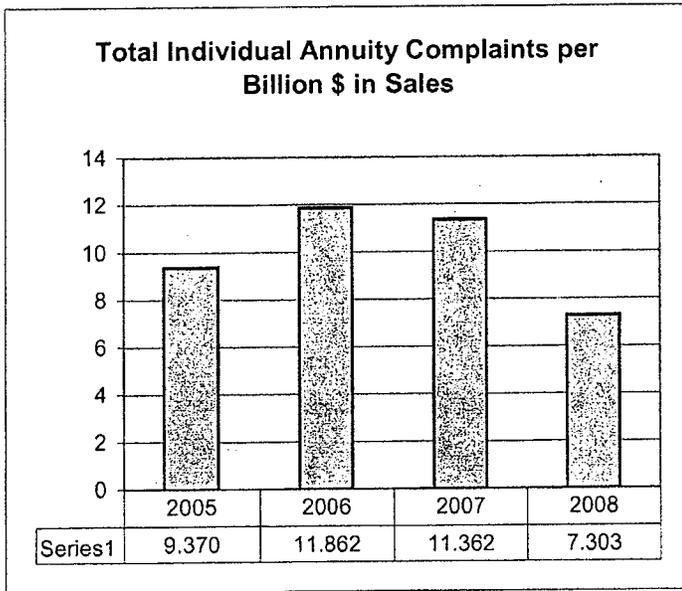
# Appendix B

## Total Individual Annuities

Year	Total Individual Annuity Complaints (a)	Total Annuity Sales (\$ in billions) (b)	Complaints per Billion \$ in Sales
2005	2024	216	9.370
2006	2835	239	11.862
2007	2920	257	11.362
2008	463	63.4	7.303

↑  
↑  
↑  
↑  
Figure is 1st quarter only  
(source - www.limra.com)

Figure is pro-rated to reflect first quarter complaints only  
Actual reported figure is 1080 as of 06/23/2008  
 $1080 / 7 \text{ months} * 3 \text{ months} = 463$



(a) Source - www.naic.org

(b) Source - www.limra.org

Complaint Comparison per Premium Dollar

# Appendix B, continued

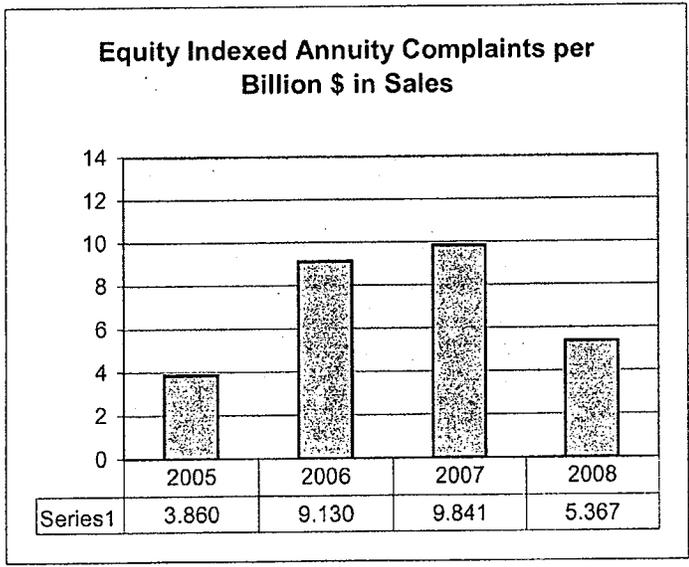
## Equity Indexed Annuities

Year	Equity Indexed Annuity Complaints (a)	Equity Indexed Annuity Sales (\$ in billions) (c)	Complaints per Billion \$ in Sales
2005	105	\$ 27.20	3.860
2006	231	\$ 25.30	9.130
2007	248	\$ 25.20	9.841
2008	31	\$ 5.78	5.367

↑  
↑  
↑  
↑

Figure is 1st quarter only  
(source - www.indexannuity.org)

Figure is pro-rated to reflect first quarter complaints only  
Actual reported figure is 72 as of 06/23/2008  
 $72 / 7 \text{ months} \times 3 \text{ months} = 31$



(a) Source - www.naic.org  
(c) Source - www.indexannuity.org

Complaint Comparison per Premium Dollar

FACT: The following information is taken from the March 2008 NAIC Customer Information Source report.

NAIC Filed Complaints	2007	2006	2005
Total (ALL Lines)	204,801	208,138	210,001
Total Annuities/% of Total	2,284/1.12%	2,157/1.04%	1,621/0.77%
FIA Specific/% of Total	248/0.12%	231/0.11%	105/0.05%
FIA Sales (in 000s)	\$25,100,000	\$25,300,000	\$27,260,000
% of all annuities (in 000s)	9.7%	10.7%	12.6%

It is clear by this data that a product representing only 10% of all annuities sold (Source: LIMRA) with only 1/10<sup>th</sup> of a percent of closed complaints has many satisfied customers.

## Old Mutual Financial Complaints

<b>Number of Policies:</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008<sup>1</sup></b>
# of In-Force Indexed Annuities	102,167	127,270	146,632	156,093
<b>Number of Complaints:</b>				
# of Indexed Annuity Complaints	125	296	296	280
<b>Indexed Annuities Ratios:</b>				
In-Force IA Policies to IA Complaints Ratio	817:1	430:1	495:1	557:1
In-Force IA Complaint Percentage	.12	.23	.2	.18

IA = Indexed Annuity

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<sup>1</sup> 2008 data as of 9/30

## Issue Status Chart: NAIC Annuity Disclosure & Suitability in Annuity Transactions Model Regulations

(As of **October 17, 2008**)

The chart tracks state adoption of the NAIC Suitability (formerly Senior Protection) in Annuity Transactions Model Regulation, the NAIC Annuity Disclosure Model Regulation and variations of the models. ACLI actively supports state adoption on a uniform basis of the NAIC Suitability in Annuity Transactions Model Regulation and the NAIC Annuity Disclosure Model Regulation. Bill text, digest and legislative history are available in ACLI's Legislative Tracker. Also, proposed and adopted regulations are available through ACLI's [Advance Services](#) and the [Market Conduct Compliance Service](#). Contacts: [Kelly Ireland](#), 202.624.2387 or [Michelle Monkou](#), 202.624.2396.

### OVERVIEW OF STATE ACTIVITY TO DATE:

29 states have adopted the NAIC Suitability in Annuity Transactions Model Regulation.

Alabama	Illinois	Maine	Nevada	Texas
Alaska	Kansas	Michigan	Ohio	Utah
Colorado	Kentucky	Montana	Oklahoma	Virginia
Georgia	Louisiana	New Jersey	Rhode Island	West Virginia
Hawaii	Massachusetts	North Carolina	South Dakota	Wisconsin
Idaho	Maryland	North Dakota	Tennessee	

\*Iowa has adopted enabling legislation for the NAIC Suitability Model.

6 states have proposed the NAIC Suitability in Annuity Transactions Model Regulation.

Connecticut	Indiana	South Carolina
Idaho	Nebraska	Pennsylvania

6 states have adopted the NAIC Senior Protection in Annuity Transactions Model Regulation.

Arizona	Delaware	Indiana
Arkansas	Florida	Nebraska

1 states has proposed the NAIC Senior Protection in Annuity Transactions Model Regulation.

California

6 states have similar or related suitability standards.

Connecticut	Iowa	Missouri
Florida	Minnesota	Oregon

18 states have adopted the NAIC Annuity Disclosure Model Regulation.

Alabama	Hawaii	Missouri	Nevada	Oregon
Alaska	Iowa	Montana	North Carolina	Utah
Arizona	Kentucky	New Jersey	Ohio	
Colorado	Maine	New Mexico	Oklahoma	

9 states have adopted variations of an older NAIC Model Regulation.

Florida	Maryland	New York	South Carolina	Wisconsin
Georgia	New Hampshire	Pennsylvania	Washington	