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May 10, 2017

Ms. Sara Crovitz
Deputy Chief Counsel
Division of Investment Management
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Application for Order of Approval Pursuant to 26(c) – Allianz Life Insurance Company of North America, et al.

Dear Ms. Crovitz:

Morgan, Lewis and Bockius LLP represents Franklin Advisers, Inc., Franklin Advisory Services, LLC, Franklin Mutual Advisers, LLC, and Templeton Global Advisors Limited (together, the "Advisers"), each an investment adviser registered under the Investment Advisers Act of 1940. The Advisers serve as investment advisers to the series of the Franklin Templeton Variable Insurance Products Trust ("FTVIPT"), a variable insurance trust consisting of 18 individual funds with over $25 billion in assets. The FTVIPT funds serve as underlying investments to variable contracts issued by more than 47 insurance companies including Allianz Life Insurance Company of North America ("Allianz").

Allianz filed an exemptive application (the "Application") on December 7, 2016, under the Investment Company Act of 1940 ("1940 Act") that, if granted by the Securities and Exchange Commission (the "Commission"), would permit the substitution of 23 existing underlying investments in 36 different Allianz variable annuity and variable life contract with 9 funds managed by Allianz Investment Management LLC ("AIM"), an affiliate of Allianz. The 23 existing funds represent approximately $21.2 billion of assets, including seven FTVIPT funds with approximately $3.89 billion Allianz assets in the seven funds. The Advisers estimates that the proposed substitutions will impact tens of thousands of contractholders with investments exceeding approximately $19.946 billion in the FTVIPT funds. For the reasons described below, the Advisers believe that granting the proposed substitutions as currently contemplated in the Application would not be in the best interests of the contractholders and would not result in the protection of investors as required by the 1940 Act.

Section 26(c) of the 1940 Act states that "It shall be unlawful for any depositor or trustee of a registered unit investment trust holding the security of a single issuer to substitute another security for such security unless the Commission shall have approved **such substitution**" (emphasis added). This language contemplates that each substitution should stand on its own particular facts-and-circumstances. Substitutions should not be granted *en masse* where the circumstances of any proposed substitution differ from fund to fund. Section 26(c) allows the Commission to approve a substitution of an underlying fund only if the "evidence establishes that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title."

When an investor buys shares in a public company, which subsequently seeks to undergo a fundamental change, corporate law usually requires the shareholders to approve such fundamental change and the rules of the Commission extensively govern the disclosures that must be made in such shareholder solicitation. Accordingly, if variable contractholders are going to have their investment choice materially changed without any input on their part, the Staff must undertake and document a rigorous public interest finding that justifies such unilateral action.

Based on the reasons and our understandings described below, the Advisers believe that granting exemptive relief necessary for the proposed substitutions as currently contemplated in the Application would not be in the best interests of the contractholders and would not result in the protection of investors as required by the 1940 Act.

***The Application contains insufficient evidence to support a "best interests" finding.*** The proposed substitutions would decrease the value of the living income guarantees and death benefits that many contractholders purchased and that are an integral feature of their variable annuities and life insurance. Allianz, having sold these contracts and the optional guarantees, no longer wants to honor them because they have become too expensive for Allianz to support, and wants the Commission to relieve Allianz of its expenses.[1] We urge the Staff to request that Allianz provide a full analysis of the effect of these substitutions on the living income and death benefit guarantees, rather than rely on conclusory representations from Allianz.

The proposed substitutions also would, for the most part, replace actively managed funds with proprietary index funds that have lower performance and that deprive contractholders of the benefit of the choices they made when entering into their contracts. Rather than add these index funds to its available fund options, Allianz seeks to "simplify" the fund menu Allianz itself

[1] Allianz's Form 10-K for 2015 noted "Over the past years, Allianz Group and its operating entities have developed operational contingency plans for various crisis scenarios. We continue to conduct scenario analysis on a regular basis to bolster our financial and operational resilience to strong shock scenarios. In addition, we continue to optimize our product design and pricing in the Life/Health business segment with respect to guarantees and surrender conditions."
https://www.allianz.com/v_1458046946000/media/investor_relations/en/results_reports/annual_report/ar2015/ar2015_group.pdf

created and remove the funds whose performance can provide additional income for contractholders. We understand that active investing may be out of favor currently, but the value added by active managers, when combined with a variable insurance product that contains floors and minimum benefits, must be carefully analyzed by the Staff on a fund-by-fund and contract-by-contract basis.

***The value of investors' guarantees will be diminished.*** Many Allianz contractholders purchased their variable contracts with investment guarantees in the form of living income guarantees and death benefits. These guarantees were priced based on the actively-managed funds available at the time of purchase. A guarantee produces more income, and is more valuable to the contractholder (and more expensive for the insurance company to maintain) when the contractholder can select actively managed funds that seek to beat, rather than just meet, a benchmark. When the substitution of an index fund lowers the payout ceiling and the guarantee becomes less valuable, there is no compensation to the contractholder for its diminished value.

The last several years have seen an increasing number of mass substitution applications where proprietary index or index-type funds are substituted for actively-managed funds. In our view, the impetus for these substitutions is the insurance companies' desire to reduce the amount they must pay out under a guarantee. Yet the applications do not acknowledge the financial harm to contractholders because of these substitutions. We note that the Application claims that "What effect the proposed Substitutions may have on the value of the benefits offered by the Contract guarantees would depend, among other things, on the relative future performance of the Target Funds and Destination Funds, which Section 26 Applicants cannot predict." We believe that Allianz would not have proposed these substitutions if they were likely to *increase* Allianz's future payouts under the existing guarantees, or even keep them stable. We urge the Staff to require of Allianz a detailed analysis of how each substitution will affect each type of guarantee it sold. Only then can the Staff make an accurate "best interests" finding on the Application.

***The Application does not appear to meet the standards for granting relief under Section 26(c).*** Section 26(c) of the 1940 Act allows the Commission to approve a substitution of an underlying fund only if the "evidence establishes that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title." The Applications do not contain actual evidence that the substitutions will be in the best interests of the affected contractholders and, therefore, may not be consistent with the protection of investors.

Allianz states that the goal of the Application is to make the contracts more attractive to existing and prospective contractholders, and to make them more efficient to administer. Two of these reasons only benefit Allianz: the ability to sell more contracts and to administer them at less cost. The third reason - to make the contracts more attractive to existing contractholders - amounts to the promise of the same or slightly lower fund fees, improved manager selection (because Allianz can more efficiently monitor its affiliate Allianz Investment Management LLC ("AIM")) and a "simplified menu" of funds (which Allianz itself created). We believe that many contractholders who purchased guarantees would be willing to give up a few basis points in cost savings in order to maintain the funds they chose as investment options and applicable guarantees. While Allianz will see a financial benefit from the substitutions, the contractholders will not.

The *substitutions* are not consistent with the policy and provisions of the 1940 Act as set out in Section 1(b) of the 1940 Act. Section 1(b) states, in relevant part, that "the national public interest and the interests of investors are adversely affected – ... (2) when investment companies are organized, operated and managed... in the interests of directors, officers, investment advisers, depositors, or other affiliated persons thereof,... rather than in the interest of all classes of such companies' security holders,... or (6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders." The proposed substitutions are designed primarily to benefit AIM and will harm contractholders, and a deeper examination of the assertions in the Application should demonstrate that it does not meet the standards for relief in Section 26.

***The Application fails to seek joint transactions relief.*** The proposed substitution transactions meet the definition of "joint enterprise or other joint arrangement or profit-sharing plan" under Rule 17d-1 under the 1940 Act (that is, an arrangement where a registered investment company and an affiliated person are joint or joint and several participants, or share in the profits, of such enterprise). Given that all of the proposed replacement funds are or will be advised by an affiliate of Allianz, this is the type of transaction that plainly is subject to Section 17(d). The standard for exemptive relief under Rule 17d-1 is different from the standard for Section 26(c), because the Commission must consider the extent to which the participation of the investment company is on a basis different from, or less advantageous than, that of other participants. The Application, without explanation, fails to seek exemptive relief under Rule 17d-1.

The Advisers' concerns are, naturally, with the loss of assets, but equally with the higher fees that will be imposed on the remaining shareholders of the FTVIPT Funds. Allianz filed a similar exemptive application, and received an order, in 2016.[2] The Advisers did not write to the Staff at that time, because the effect on their remaining shareholders was not as material. The Application, however, presents fundamental issues for the Staff to resolve in considering how it makes a best interests finding in mass substitutions such as the one presented here. Moreover, the Advisers have observed the increasing number of mass substitution applications, such as those filed by Hartford Life Insurance Company and Commonwealth Annuity and Life Insurance Company, and are troubled by the trend of issuing these orders without any apparent regard to the issues raised in this letter and in the hearing requests filed on the Hartford Life applications. Last year, the Director of the Division of Investment Management warned investors to consider insurance product buyout offers carefully:

> As the dust continues to settle after the financial crisis, insurers continue to move away from the offering of variable insurance contracts that feature the significant types of guaranteed income benefits and death benefits previously offered and sold. In this regard, the staff continues to see buyout and exchange offers, which I spoke briefly about last year. The staff believes these sorts of offers should remain under a spotlight given our ongoing concern that they may not be beneficial for all, or even most, contract owners. It is difficult to quantify the value of a living

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[2] Investment Company Act Release Nos. 32207 (Aug. 3, 2016) (notice) and 32242 (Aug. 28, 2016) (order).

benefit, which changes over time with market movements and other variables. It is thus difficult to compare contracts in an exchange offer, or to assess any offer for a buyout of one's contract.[3]

If the Staff is concerned about investors **who have a choice** about what happens to their insurance contract, the Staff should be even more concerned about investors in fund substitutions **who have no choice**. If the Staff acknowledges that an investor weighing a buyout offer will find it difficult to quantify the value of a living benefit, it is equally difficult for investors whose funds will be substituted to decide whether they should surrender their contracts and buy another contract elsewhere. Given the *en masse* nature of the proposed substitutions, the multiple affected registered funds and variable contracts, and the thousands of contractholders that would be deprived of the benefit of the choices they made when they entered into their contracts, the Staff appears poised to make a one-size-fits-all public interest finding that is unsupported under Section 26.

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The Commission should be concerned about potential negative impacts that a substitution order could have on contractholders and should consider substitutions under Section 26(c) only when an insurer intends to replace a fund that is impaired in some way, is in jeopardy of being liquidated, has been subject to fraud or is subject to other unforeseen circumstances. In these situations, the fund in question would need to be replaced for the protection of the fund's investors. The Commission should not approve substitutions in situations where it appears that the impetus for change is not unforeseen circumstances experienced by the funds, but the insurance company's desire to walk away from a bargain that has turned sour.

If the Application proceeds to being noticed by the Commission without a satisfactory resolution of the issues presented in this letter, the Advisers intend to request a hearing on the Application. Under 17 CFR 200.30-5, which governs hearing requests under the 1940 Act, we believe that the Application "present[s] significant issues that have not been previously settled by the Commission" and, further, raise "questions of policy" (Rule 200.30-5(a)(1)). We also believe that the Advisers would be "interested persons" within the meaning of Rule 200.30-5 and accordingly meet the other prerequisite for making a hearing request.

[3] https://www.sec.gov/news/speech/grim-remarks-ali-cle-2016-conference-life-insurance-products.html

Thank you in advance for considering this submission. If you should have any questions or would like to discuss the contents of this letter, please feel free to call me at 202-373-6725. We would also be happy to set up a time to discuss these issues in person.

Very truly yours,

Thomas S. Harman

cc: The Hon. Jay Clayton, Chairman
The Hon. Michael S. Piwowar, Commissioner
The Hon. Kara M. Stein, Commissioner
David Grim, Director, Division of Investment Management
Douglas Scheidt, Associate Director and Chief Counsel
Rick A. Fleming, Office of the Investor Advocate
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