Morgan Lewis

Morgan, Lewis & Bockius LLP
1111 Pennsylvania Avenue, NW
Washington, DC 20004-1806
Tel. +1.202.373.6000
Fax: +1.202.373.6001
www.morganlewis.com

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Thomas S. Harman
Partner
+1.202.373.6725
thomas.harman@morganlewis.com

February 12, 2020

Ms. Vanessa Countryman
Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Reply to Opposition to Hearing Request from Allianz Life Insurance Company of North America, et al. on Application File No. 812-14722

Dear Ms. Countryman:

This letter responds, on behalf of our clients Franklin Advisers, Inc., Franklin Mutual Advisers, LLC and Templeton Global Advisors Limited (together, the "Advisers"), to Allianz Life Insurance Company of North America, et al.'s ("Allianz") letter, dated January 23, 2020 (the "Allianz Letter"), opposing the Advisers' request for a hearing filed with respect to the above-captioned exemptive application (the "Application"). While the Advisers' request for a hearing, dated January 14, 2020, thoroughly outlines why a hearing is required, in reply to the Allianz Letter there are two points that the Advisers would like to emphasize and supplement. First, the Advisers are "interested persons" for purposes of Rule 0-5 under the Investment Company Act of 1940 (the "1940 Act") and therefore have standing to request a hearing. Second, because there is no evidence in the record other than conclusory representations supplied by Allianz, *Susquehanna*[1] is applicable and requires that an order not be issued until the Securities and Exchange Commission (the "Commission") makes the evidentiary-based findings required by the 1940 Act.

I. The Advisers Have Standing to Request a Hearing

The Advisers are interested persons within the meaning of Rule 0-5 under the 1940 Act and, accordingly, meet the other prerequisites for making a hearing request. To be an interested person entitled to request a hearing on an application under the 1940 Act, a requestor must state an ownership or other direct interest in the application at issue or demonstrate that it is likely to be harmed by the granting of the application. If Allianz is permitted to replace certain series of the Franklin Templeton Variable Insurance Products Trust (the "FTVIPT Funds"), a variable

[1] See Susquehanna Int'l Grp., LLP v. SEC, 866 F.3d 442, 443 (D.C. Cir. 2017) ("*Susquehanna*").

insurance trust registered under the 1940 Act, with proprietary funds, the loss of assets from the FTVIPT Funds would result in a loss of economy of scale for the remaining shareholders in the FTVIPT Funds. Such a loss in economy of scale would result in an increase in the remaining shareholders' individual costs. A decrease in economy of scale and accompanying increase in shareholder costs for the FTVIPT Funds could result in the Funds being less competitive, which is a specific and material harm to the Advisers that grants standing.[2] Additionally, as previously noted in the Advisers' hearing request, the Advisers will also suffer specific and material harm if the Application is granted by losing advisory fee revenues.

In response to Allianz's assertion that the Commission orders cited in our hearing request are not controlling, we note that in each order, the Commission stated who is *not* an interested person for purposes of Rule 0-5. As Allianz has noted, the facts between those orders and the Advisers' hearing request are vastly different, which in turn supports the Advisers' status as interested persons. In *The Chase Manhattan Bank, N.A. and Chemical Bank,*[3] a community organization asserted that it was an interested person because some of its members' pensions were invested in unit investment trusts for which the applicants served as custodian. The Commission denied the organization's request for a hearing, noting that "a requestor must state an ownership or other direct interest . . . or demonstrate that it is likely to be harmed by the granting of the application" which was not met by asserting that its members had an interest or were likely to be harmed. Unlike the community organization, the Advisers have a direct, not a derivative, interest in the Application and are likely to suffer harm that is directly related to their organizational purpose. Further, in *Potomac Capital Investment Corporation, et al.*,[4] the Commission noted that the petitioner fund, in which the applicants were former but no longer current shareholders, did not state an ownership or other direct interest in the applicants, nor did it "demonstrate that it is likely to be harmed by the granting of the instant application, nor . . . provide any other basis for concluding that the Fund is an 'interested person.'" Unlike that fund, the Advisers *have* demonstrated the likelihood that they will be harmed if the Application is granted. The Commission similarly denied a petitioner's request for a hearing in a pair of orders involving "interested person" status under Section 2(a)(19) of the 1940 Act.[5] Although the order involved "interested person" status under Section 2(a)(19), the Commission's analysis goes into discussing the denial of a hearing request by the petitioner. The petitioner did not assert an ownership or other direct interest in the proposed transaction or demonstrate that it was likely to be harmed by the granting of the order, as required by Rule 0-5. Those facts are distinguished from the Advisers' request, as the Advisers have demonstrated their harm if the Application is granted.

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2 *See, e.g.*, Warth v. Seldin, 422 U.S. 490, 508 (1975) (noting that the right to a hearing, and the ability to contest the denial of a hearing, extends to persons and entities, like the Advisers, that have suffered an "injury in fact"—an invasion of a legally protected interest that is concrete and particularized); and Twin Rivers Paper Company LLC v. SEC, No. 18-1213, slip op. at 12-13 (D.C. Cir. 2019) (determining that standing exists where a party with a concrete interest is either an intended beneficiary of the securities laws at issue or the interest asserted by such party systematically coincides with those of shareholders).

3 Investment Company Act Release No. 23186 (May 14, 1998).

4 Investment Company Act Release No. 17238 (Nov. 28, 1989).

5 *In re* Shearson Loeb Rhoades Inc., et al., Investment Company Act Release Nos. 11834 and 11835 at nn.2 (June 26, 1981).

While Allianz notes that the Advisers may lose fees due to shareholder redemptions, there is a strong difference between losing fee revenue due to voluntary shareholder redemptions and having fee revenue taken away through a unilateral government order.[6] Thus, the Advisers are likely to suffer demonstrable and material harm if the order is issued and have identified concrete interests that would be impaired. They have, therefore, standing to request a hearing.

II. *Susquehanna* Applies and Requires an Evidentiary Record

Susquehanna is applicable and therefore the Commission may not base its determination to issue an order on conclusory statements made by Allianz. Because the current record contains no findings by the Commission as required by Section 26(c) of the 1940 Act nor any evidence upon which the findings required by Section 26(c) can be made, a hearing must be held prior to the issuance of any exemptive order.

Susquehanna involved the review of an order issued by the Commission pursuant to Section 19(b)(2) of the Securities Exchange Act of 1934 (the "Exchange Act").[7] Prior to issuing an order under Section 19(b)(2), Section 19(b)(2)(C)(i) requires that the Commission make findings "consistent with the requirements of this title and the rules and regulations issued under this title . . . ."[8] Upon review of the administrative record, in an opinion authored by Chief Judge Merrick B. Garland, the D.C. Circuit found that the Commission placed "unquestioning reliance" on the applicant's arguments.[9] The D.C. Circuit stated that the Commission is required to make findings and determinations and "not merely accept those made by" the applicant.[10] Upon finding that the record lacked any independent analysis by the Commission or any critical review of the arguments submitted before it, the D.C. Circuit remanded the case back to the Commission to properly evaluate the facts underlying the order.[11] Upon remand, the Commission revoked its previously issued order due to the lack of evidence in the record and the accompanying conclusory determinations.[12] Upon resubmission of the request for an order, the Commission published the

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6 Any Commission order that effectively abrogated, modified, or impaired the Advisers' existing contractual rights would also result in an uncompensated "taking" of the Advisers' valuable property, in violation of the Fifth Amendment to the U.S. Constitution. *See, e.g.*, Lynch v. United States, 292 U.S. 571, 579 (1934) (holding that valid contracts are property); and Cienega Gardens v. United States, 331 F.3d 1319, 1334 (Fed. Cir. 2003) (holding that agreements between private parties give rise to protected property interests for Due Process Clause purposes).

7 *Susquehanna*, 866 F.3d at 443-45; *see also* Order Approving Proposed Rule Change Concerning The Options Clearing Corporation's Capital Plan, Exchange Act Release No. 77112 (Feb. 11, 2016).

8 15 U.S.C. § 78s(b)(2)(C)(i).

9 *Susquehanna*, 866 F.3d at 447.

10 *Id.*

11 *Id.* at 447 & 451.

12 *See* Order Disapproving Proposed Rule Change Concerning The Options Clearing Corporation's Capital Plan ("Disapproval Order"), Exchange Act Release No. 85121 (Feb. 13, 2019) ("We recognize that the Commission previously approved this proposed rule change. But we did so, in significant part, in reliance upon OCC's representations . . . . [T]he Commission must critically evaluate the representations made and the conclusions drawn by OCC. After conducting such an analysis on remand, and after giving the parties the opportunity to

request for public comment[13] and then instituted proceedings after receipt of comments.[14] When the Commission finally did issue an order, the order contained critical analysis of the applicant's representations and made four distinct findings under each Exchange Act section and rule thereunder implicated by the issuance of the order.[15]

Similar to *Susquehanna*, the Application requests the Commission issue an order. Similar to Section 19(b)(2)(C)(i) of the Exchange Act, Section 26(c) of the 1940 Act requires that the Commission, prior to issuing an order, determine that "the evidence establishes that [such order] is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title."[16] As in *Susquehanna*, the record for the Application consists solely of Allianz's representations and conclusory statements with no independent findings made by the Commission or any critical review by the Commission of Allianz's assertions. Allianz even acknowledges in its Letter that no analysis has been performed regarding the effects that the substitutions will have on the value of guarantees under the variable annuity and variable life contracts.[17] Therefore, as the Commission concluded in the Disapproval Order, "relying on [the Applicant's] representations, without more, is insufficient."[18]

Pursuant to *Susquehanna* and the Commission's own standards, an order cannot issue until "the representations made and the conclusions drawn" are critically evaluated.[19] Therefore, a hearing must be allowed so that an evidentiary record can be established and the requisite Commission findings and determinations can be made.

CONCLUSION

Thank you for considering the hearing request and this supplementary information.[20] For the reasons set forth in the hearing request as well as in this supplementary reply filed in response to the Commission's Notice and the Allianz Letter, the need for, and the appropriateness of, a

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submit additional materials to the Commission, we have determined that OCC has failed to meet its burden . . . .").

13 Exchange Act Release No. 86725 (Aug. 21, 2019).

14 Exchange Act Release No. 87603 (Nov. 22, 2019).

15 *See* Order Approving Proposed Rule Change, as modified by Partial Amendment No. 1, Concerning a Proposed Capital Management Policy That Would Support The Options Clearing Corporation's Function as a Systemically Important Financial Market Utility, Exchange Act Release No. 88029 (Jan. 24, 2020) (addressing with specificity the effects under Sections 17A(b)(3)(F) and 17A(b)(3)(D) of the Exchange Act, as well as Rules 17Ad-22(e)(2) and 17Ad-22(e)(15) thereunder).

16 15 U.S.C. § 80a-26(c).

17 Allianz Letter at 6.

18 Disapproval Order, Exchange Act Release No. 85121.

19 *Id.*

20 We are also attaching immediately following this reply letter, as support for the hearing, a letter written by Raymond James Insurance Group, Inc. Although this letter has been previously filed with the Commission, we believe that it should be made part of the public record as it further details shareholder harm that is likely to result if the Application is granted.

hearing on the Application is manifest. If you should have any questions or would like to discuss this reply letter, please feel free to call me at 202 373-6725 or Monica L. Parry at 202 373-6179.

Please find enclosed proof of service upon Allianz in the form of an affidavit.

Very truly yours,

Thomas S. Harman

cc: The Hon. Jay Clayton, Chairman
The Hon. Robert J. Jackson, Jr., Commissioner
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Allison Herren Lee, Commissioner
Dalia Blass, Director, Division of Investment Management
Paul Cellupica, Deputy Director and Chief Counsel, Division of Investment Management
Rick A. Fleming, Office of the Investor Advocate
Alison Baur, Franklin Templeton Investments
Kevin Kirchoff, Franklin Templeton Investments
Erik T. Nelson, Senior Securities Counsel, Allianz Life Insurance Company of North America
Chip C. Lunde, Carlton Fields, LLP

January 14, 2020

Ms. Dalia Blass, Director
Division of Investment Management
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Allianz Substitution; File No. 812-14722 ("Allianz Request")

Since the financial crisis, insurance companies have submitted a steady stream of variable annuity sub-account substitution requests with the Securities and Exchange Commission ("SEC" or "Commission") pursuant to Section 26(c) of the Investment Company Act of 1940. With the exception of the substitution request filed initially in 2015 by Hartford Life Insurance Company and subsequently withdrawn (SEC File Nos. 812-14446 & 812-14447) ("Hartford Request"), to the best of our knowledge, the Commission has approved all of the substitution requests. Let us set aside for a second the fact that insurance companies are using a regulatory process that was designed to orderly liquidate a mutual fund that has insufficient assets and/or performance to remain in existence, not to make wholesale changes to the sub-account lineup of existing variable annuities. Let us instead examine what all of these requests have in common:

1. **All of the variable annuities in question have living benefits attached to the majority of the policies that were taken into consideration and relied upon by the policyholders when purchased.** These benefits guarantee a minimum and known amount of future income (provided the rules of the benefit are followed). For example, on the day of purchase, policyholders know the minimum amount of income they will receive for their lifetime, regardless of the performance of the annuity sub-accounts. For this guarantee, the policyholder will typically pay 1-1.5% per year. The only way to get more income than the initial guarantee is to earn a return greater than the guaranteed growth of the living benefit income base. If this occurs, the income base is increased (known in the industry as a "step-up"), which in turn increases the anticipated future income. Accordingly, the choice of the sub-accounts is very important, and each of these factors are taken into consideration when making that choice. It is the role of the advisor to recommend the asset allocation amongst the available sub-accounts that provides the best opportunity to get a "step-up".

2. **The request would substitute more volatile funds for less volatile funds primarily to benefit the insurance company, not the policyholders.** As we see with Allianz's request, the goal is often to replace actively managed funds for passively managed indexed funds. Providing a minimum amount of guaranteed income to policyholders for life on an account value that can fall in value is a risky proposition for the insurance companies. The financial crisis taught the variable annuity industry just how risky that can be. Insurance companies attempt to manage that risk by hedging the various sub-accounts. It is far easier for the insurance companies to hedge an indexed sub-account than an actively managed sub-account. In addition, the less volatile the sub-account, the cheaper the hedge for the insurance companies. These resulting benefits for the insurance companies generally result in marginal, if any, benefits to the policyholder.

3. **The insurance company makes no compelling argument as to why the substitution is in the policyholder's best interest.** Often times, the replacing sub-accounts are marginally cheaper, but the policyholder typically gives up volatility in exchange for a reduction in cost. Due to the already purchased guarantees, it is the volatility that provides the best opportunity to increase the guaranteed income to the policyholder. The policyholder has essentially bought insurance to

protect against the downside risk that comes with the volatility and therefore benefits most from the corresponding upside potential.

In short, in all of these substitution requests, it is the insurance company that stands to benefit most. The policyholder's benefits, if any, are trivial compared to the financial benefit the insurance company stands to gain.

Raymond James does business with almost twenty different variable annuity companies – Allianz amongst them. Over the last eight years, we have had to deal with the aftermath of these substitutions far too often. In most cases, our clients have few options. It typically comes down to accepting the new funds or giving up the valuable income benefits that they have paid for each year. Since the client rarely benefits from the substitution, and often is disadvantaged, it is never a good conversation. In the end, the client often feels as though the insurance company is changing the rules of the game after the fact.

We ask that the SEC take the time to thoroughly review the Allianz Request as well as any similar future requests from any other variable annuity company. Without an in-depth analysis of the pros and cons, these types of requests will continue. In that spirit, Raymond James would be happy to be a resource for the Commission on any such review. We also believe that no request should be approved without the insurance company fully disclosing any potential conflicts of interest.

Finally, since we previously commented on the Hartford Request, we would like to acknowledge that the Allianz Request differs in one very significant way. In this case, the replacing funds have track records and costs that compare favorably to the funds that would be replaced. Therefore, this specific request may indeed be acceptable. However, this can only be determined by a thorough vetting of both the pros and cons to the policyholder. In addition, we believe that such a thorough review by the Commission accompanied by detailed reasoning for approving or denying the request would send a much needed message to the industry and will likely eliminate most future requests.

Respectfully,

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Scott Stolz
President, Raymond James [I]nsurance Group, Inc.

cc: The Hon. Walter J. Clayton, Chairman
The Hon. Robert J. Jackson Jr., Commissioner
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Allison Herren Lee, Commissioner

Vanessa Countryman, Secretary
Rick A. Fleming, Office of the Investor Advocate
Randy Gabrielson. Allianz Life Insurance Company