CARLTON FIELDS

ATTORNEYS AT LAW

1025 Thomas Jefferson Street, NW | Suite 400 West
Washington, DC 20007-5208
202.965.8100 | fax 202.965.8104
www.carltonfields.com

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West Palm Beach

Chip Lunde
Shareholder
202-965-8139 Direct Dial
clunde@carltonfields.com

July 31, 2020

BY E-MAIL

Ms. Vanessa Countryman
Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington D.C. 20549
Secretarys-Office@sec.gov

Re: In the Matter of Allianz Life Insurance Company of North America, et al., Application for an Order of Substitution (File No: 812-14722)

Dear Ms. Countryman,

Allianz Life Insurance Company of North America and Allianz Life Insurance Company of New York hereby file the enclosed Allianz Written Statement in support of the above-referenced substitution application (the "Application") pursuant to the Commission's July 1, 2020 Order Granting Hearing and Scheduling Filing of Statements regarding the Application (Investment Company Act Release No. 33916).

The enclosed Allianz Written Statement in support of the Application has been served by e-mail on the opposing parties in accordance with the Order, and as reflected in the Certificate of Service attached to the Written Statement.

Respectfully submitted,

Chip Lunde

Chip Lunde

Enclosures

cc: Dalia Blass, Director, Division of Investment Management *(w/ encl.)*
Paul G. Cellupica, Deputy Director and Chief Counsel, Division of Investment Management *(w/ encl.)*
Erik T. Nelson, Senior Securities Counsel, Allianz Life Insurance Company of North America *(w/ encl.)*
Thomas S. Harman, Morgan, Lewis & Bockius LLP *(w/ encl.)*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of Allianz Life Insurance Co. of North America, et al.	**File No. 812-14722**

ALLIANZ'S WRITTEN STATEMENT IN SUPPORT OF APPLICATION FOR AN ORDER OF SUBSTITUTION

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Pursuant to the Commission's July 1, 2020 Order Granting Hearing Request and Scheduling Filing of Statements,[1] Allianz Life Insurance Company of North America and Allianz Life Insurance Company of New York (together, "Allianz") submit this Written Statement in support of the above-referenced substitution application (the "Application").[2] The hearing request ("Hearing Request") was submitted by Franklin Advisers, Inc., Franklin Mutual Advisers, LLC, and Templeton Global Advisors Limited (collectively, the "Advisers").[3]

I. Executive Summary

Allianz respectfully requests that the Commission issue an order approving the proposed substitutions ("Substitutions") described in the Application for the following reasons:

- The Substitutions meet all of the conditions and standards for a Commission order of approval pursuant to Section 26(c). Specifically, the Substitutions will benefit and protect Contract owners by resulting in:
    - **Lower fees.** The Substitutions will result in lower fund fees overall (26 basis points, on average) for Contract owners invested in the replacement funds;
    - **Similar funds with well-known advisers and favorable performance.** The replacement funds have similar objectives, strategies, and risks to the target funds, are managed by well-known investment advisers, and have favorable performance histories;

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[1] Order Granting Hearing Request and Scheduling Filing of Statements In the Matter of Allianz Life Insurance Co. of North America, et al., Rel. No. IC-33916 (July 1, 2020) (File No. 812-14722).

[2] On December 7, 2016, Allianz Life Insurance Company of North America, et al. (the "Applicants") filed the Application for an order approving the substitution of certain securities that fund certain Allianz variable annuity and variable life insurance contracts (the "Contracts") pursuant to Section 26(c) of the Investment Company Act of 1940 (the "1940 Act) and an order of exemption pursuant to Section 17(b) of the 1940 Act from Section 17(a) of the 1940 Act. Applicants amended and restated the Application on May 31, 2017, August 4, 2017, May 31, 2019, and August 13, 2019 in response to Commission staff ("Staff") comments.

[3] Letter from the Advisers to Vanessa Countryman, dated January 14, 2020, submitted by Morgan, Lewis & Bockius LLP.

- **A wide variety of investment options.** Contract owners will continue to have access to a large number of investment options representing a wide variety of asset categories;
- **No cost or expense.** Allianz will bear all the costs and expenses of the Substitutions, and the Substitutions will not alter Allianz's obligations under the Contracts;
- **Transactions consistent with the Contracts and disclosure.** The ability to effect substitutions is a fully-disclosed contractual right reserved by Allianz under the Contracts, and this contractual right serves as an important basis on which Allianz offered the Contract guarantees; and
- **No costly forced redemptions.** The Substitutions will not result in the type of costly forced redemption that Section 26(c) was intended to guard against.

- The Commission and its Staff have conducted a thorough and independent analysis of the Application for over three years. This independent analysis is evidenced by the administrative record, including the Application, as amended and restated in response to various comments from the Staff, and the Commission's consideration of issues raised by the Advisers as reflected in the notice of the Application issued on December 20, 2019.[4]
- Approval of the Substitutions is supported by overwhelming precedent spanning decades. The Commission has issued nearly 200 substitution orders under Section 26(c) since the early 1980s. The terms and conditions of the Application are fully consistent with the terms and conditions of other substitution applications that have

[4] Allianz Life Insurance Company of North America, et al., Rel. No. IC-33721 (Dec. 20, 2019) (File No. 812-14722) [hereinafter, "Notice of Application"].

been developed over the years by the Staff and previously approved by the Commission.

- The Advisers' claims regarding the Application, the Commission's review of the Application, and the standards for approval under Section 26(c) are factually inaccurate and substantively without merit. The Advisers have undergone the substitution process many times – without objection – and have benefited from that process. No other target fund manager has challenged the Substitutions.

II. Summary of the Application

Allianz seeks to substitute the shares of 13 existing funds listed below (the "target funds") with shares of the corresponding replacement funds listed below (the "replacement funds").

Substitution	Target Fund	Replacement Fund
1	Fidelity VIP FundsManager 50% Portfolio	AZL Balanced Index Strategy Fund
2	Templeton Growth VIP Fund	AZL MSCI Global Equity Index Fund
3	BlackRock Global Allocation V.I. Fund	AZL Moderate Index Strategy Fund
4	Fidelity VIP FundsManager 60% Portfolio	AZL Moderate Index Strategy Fund
5	Franklin Allocation VIP Fund	AZL Moderate Index Strategy Fund
6	Franklin Income VIP Fund	AZL Fidelity Institutional Asset Management Multi-Strategy Fund
7	PIMCO All Asset Portfolio	AZL Fidelity Institutional Asset Management Multi-Strategy Fund
8	Franklin Strategic Income VIP Fund	AZL Fidelity Institutional Asset Management Total Bond Fund
9	Franklin Mutual Shares VIP Fund Franklin Mutual Shares VIP Fund	AZL Russell 1000 Value Index Fund AZL Russell 1000 Value Index Fund
10	Dreyfus VIF Appreciation Portfolio	AZL S&P 500 Index Fund
11	PIMCO Global Multi-Asset Managed Allocation Portfolio	PIMCO Balanced Allocation Portfolio
12	PIMCO Global Bond Opportunities Portfolio (Unhedged)	PIMCO Global Core Bond (Hedged) Portfolio
13	PIMCO Dynamic Bond Portfolio	PIMCO Total Return Portfolio

The Substitutions are part of an ongoing effort by Allianz to make its Contracts more attractive to existing and prospective Contract owners and more efficient to administer.[5] The Substitutions are in furtherance of the exercise by Allianz of rights reserved under the Contracts and disclosed in the statutory prospectuses for the Contracts.

Allianz believes the Substitutions will benefit Contract owners in several ways, consistent with the Commission's longstanding standards for substitutions. Perhaps most significantly, the Substitutions will reduce the amount of management fees and net fund expenses borne overall by Contract owners who are invested in the replacement funds. In addition, Contract owners will continue to have access to investment options with a wide variety of asset categories and professional investment managers. Further, Allianz will bear all of the expenses and transaction costs of the Substitutions. These and other benefits are described in more detail, below.

Lower Fees. The Substitutions will result in lower fund fees for Contract owners. First, the ***management fees*** for each replacement fund are the same or lower than those for each corresponding target fund.[6] As the Commission knows, fund management fees cannot be increased without shareholder approval. In addition, the ***total net operating expenses*** of each replacement fund are the same or lower than those of each corresponding target fund.[7] Notably, the replacement funds' total net operating expenses will be lower than those of the corresponding target funds by:

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[5] Efficiencies in administration have potential benefits for Contract owners, as well as Allianz. For example, such efficiencies better enable Allianz to offer over the lives of the Contracts an array of investment options and product features that remains up-to-date in light of changing market conditions and investor needs and preferences.

[6] Condition 2 of the Application provides, in relevant part, "[f]or each Substitution, the combined current management fee and 12b-1 fee of the [replacement fund] at all asset levels will be no higher than that of the corresponding [target fund] at corresponding asset levels." (Application, p. 23.) For Substitution 7, the target fund is a fund of funds, and the combined management fee and 12b-1 fee for the replacement fund is lower than the combined management fee, 12b-1 fee, and estimated acquired fund management and 12b-1 fees for the corresponding target fund. (Application, p. 10.)

[7] Application, pp. 113-131. The lower fees result, in part, from Allianz commitment to lower management fees applicable to replacement funds involved in Substitutions 2 through 8.

- ***10 or more basis points,*** for 11 out of 13 Substitutions; and
- ***26 basis points***, on average.[8]

The Substitutions to replacement funds with lower fees offer substantial benefits to Allianz's Contract owners and are essential to keep Allianz's products competitive in the marketplace.

Comparison of the Funds. Each replacement fund and its corresponding target fund have similar or substantially similar investment objectives, principal investment strategies, and principal risks.[9] The Application includes a side-by-side comparison of the investment objectives, principal investment strategies, and principal risks.[10] Allianz submits that the degree of comparability of the respective funds is consistent with prior Commission orders under Section 26(c) for similar substitutions.[11]

Contracts Offer a Wide Variety of Investment Options. After the Substitutions, the Contracts will offer between 13 and 50 investment options, and the investment options available under the Contracts will continue to represent a wide variety of asset categories, including Short-Term Bonds, Specialty, Cash Equivalent, Intermediate-Term Bonds, International Equity, Global Equity, Large Cap Value, Large Cap Growth, Large Cap Blend, Mid Cap, Small Cap, and Balanced.[12] Accordingly, Contract owners will continue to have access to a wide variety of investment options to pursue investment strategies consistent with their investment objectives.

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[8] Application, pp. 113-131. Expense reductions are based on a comparison of fund expenses as reflected in Appendix C of the Application, including management fee reductions that apply upon approval of the Substitutions.

[9] Notice of Application, p. 12.

[10] Application, pp. 31-112.

[11] Notice of Application, p. 12.

[12] Application, p. 6.

Favorable Performance History. The performance histories of the replacement funds compare favorably to those of the target funds.[13] Recent performance of the replacement funds has been particularly favorable relative to the performance of the target funds managed by the Advisers, as shown in the table below:[14]

	Average Annual Total Returns for the periods ended June 30, 2020		
Replacement Fund			
Target Fund			
	1 year	**5 years**	**10 years**
AZL MSCI Global Equity Index Fund, Class 2	2.31%	2.52%	4.82%
Templeton Growth VIP Fund, Class 2	-7.22%	0.37%	6.02%
AZL Moderate Index Strategy Fund, Class 1	4.37%	5.70%	8.80%
Franklin Allocation VIP Fund, Class 2	4.56%	4.75%	7.88%
AZL Fidelity Institutional Asset Management Multi-Strategy Fund, Class 2	8.08%	5.45%	7.35%
Franklin Income VIP Fund, Class 2	-7.40%	2.96%	5.89%
AZL Fidelity Institutional Asset Management Total Bond Fund, Class 2	7.35%	4.24%	--%
Franklin Strategic Income VIP Fund, Class 2	-1.65%	2.10%	3.79%
AZL Russell 1000 Value Index Fund, Class 2	-9.56%	3.93%	9.64%
Franklin Mutual Shares VIP Fund, Class 2	-14.79%	0.56%	6.59%

Contracts Offer a Wide Variety of Investment Managers. The investment options available under the Contracts are managed and/or subadvised by a wide variety of affiliated and unaffiliated asset managers.[15] Of the *72* investment options available through the Allianz

[13] Application, p. 19. The Application includes a table showing target fund and replacement fund performance histories.

[14] Source: Morningstar. For Substitutions in which two classes of a target fund are involved, the table reflects performance for Class 2, which is the more expensive class.

[15] Application, p. 6.

separate accounts, ***32*** are managed by asset managers that are ***not affiliates*** of Allianz, and an additional ***17*** are subadvised by asset managers that are ***not affiliates*** of Allianz.

Conditions of the Application. Allianz has agreed that any order approving the Substitutions will be subject to nine procedural and substantive conditions that the Commission and its Staff have developed over time to serve the public interest and to protect investors, such as the Contract owners.[16] These include, in substance, the following:

1. The Substitutions will be consistent with the terms of the Contracts and state insurance laws;
2. Allianz or an affiliate will pay all expenses and transaction costs of the Substitutions. The Substitutions will not cause the fees and charges under the Contracts currently being paid by Contract owners to be greater after the proposed Substitution than before the proposed Substitution. For each Substitution, the combined current management fee and Rule 12b-1 fee of the replacement fund at all asset levels will be no higher than that of the corresponding target fund at corresponding asset levels;
3. The Substitutions will be effected at the relative net asset values, and the Substitutions will be effected without change in the amount or value of any Contracts held by affected Contract owners;
4. The Substitutions will in no way alter the tax treatment of affected Contract owners in connection with their Contracts, and no tax liability will arise for affected Contract owners as a result of the Substitutions;

[16] Notice of Application, pp. 11 and 14.

5. The rights or obligations of Allianz under the Contracts of affected Contract owners will not be altered in any way;
6. Allianz will offer free transfers to different investment options available under the Contracts for a minimum of 30 days before and after the Substitutions;
7. Allianz will provide pre- and post-Substitution notices to Contract owners;
8. Allianz will provide each Contact owner current prospectuses for the replacement funds; and
9. The replacement funds will be subject to a 2-year expense cap relative to the net expenses of the corresponding target funds.

The foregoing terms and conditions of the Application are consistent with applicable precedent, which includes not only the precedent specifically cited by Allianz in the Application[17] but also the Commission's prior approval of almost 200 other substitution applications since 1980.

Consistent with Section 26(c) Standards for Approval. The terms and conditions of the Substitutions are consistent with the principles and purposes of Section 26(c) and do not entail any of the abuses that Section 26(c) is designed to prevent. Allianz respectfully submits that the information and analysis contained in the Application demonstrate that each proposed Substitution meets all of the conditions and standards for a Commission order of approval pursuant to Section 26(c).

III. Legal Analysis of the Substitutions Under Section 26(c)

A. Section 26(c)

Section 26(c) of the 1940 Act prohibits any depositor or trustee of a unit investment trust holding the security of a single issuer from substituting the securities of another issuer without the approval of the Commission. Section 26(c) states:

[17] Application, p. 24 at note 11.

> The Commission shall issue an order approving a substitution if the evidence establishes that the substitution is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

B. Legislative History

As the Commission knows, Section 26(c) was enacted by Congress as part of the 1970 amendments to the 1940 Act.[18]

In 1966, the Commission, concerned with the high sales charges then common to most unit investment trusts and the disadvantageous position in which such charges placed investors who did not want to remain invested in the substituted security, recommended to Congress that Section 26 be amended to require that a proposed substitution of the underlying investments of a trust be approved by Commission order prior to effecting the transaction.[19]

Congress responded by enacting Section 26(c) to require that the Commission approve certain substitutions by the depositor of investments held by unit investment trusts. As the legislative history makes clear, Congress' concern underlying Section 26(c) related to the lack of recourse and potentially additional fees experienced by investors in a ***single-security*** unit investment trust in the case of a substitution.[20] The Senate Report on the bill explained the purpose of Section 26(c) as follows:

> The proposed amendment recognizes that in the case of the unit investment trust holding the securities of a single issuer notification to shareholders does not provide adequate protection since the only relief available to shareholders, if dissatisfied, would be to redeem their shares. A shareholder who redeems and reinvests the proceeds in another unit investment trust or in an open-end company

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[18] Public Law 91-547, approved December 14, 1970, 84 Stat. 1413.

[19] Securities and Exchange Commission, Public Policy Implications of Investment Company Growth (1966) at 337 ("1966 SEC Report").

[20] Notably, the Commission narrowed its original proposal so that approval would be required only if the unit investment trust held securities issued by a single issuer. According to the legislative history of Section 26(c), "[t]he Commission and the Investment Company Institute agree that the purpose of this amendment [to add Section 26(b) (later renumbered Section 26(c))] would be met if it were limited to unit investment trusts which hold the securities of a single issuer." *Investment Company Act Amendments of 1967: Hearings on H.R. 9510 and H.R. 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce,* 90th Cong. 81 (1967) (Memorandum of the Securities and Exchange Commission).

> would under most circumstances be subject to a new sales load. The proposed amendment would close this gap in shareholder protection by providing for [Commission] approval of the substitution. The [Commission] would be required to issue an order approving the substitution if it finds the substitution consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.[21]

Section 26(c) affords this protection to investors by preventing a depositor or trustee of a unit investment trust that holds shares of one issuer from substituting those shares with the shares of another issuer unless the Commission approves the substitution.

C. Administrative History of Section 26(c)

The Commission has substantial experience administering Section 26(c), having issued nearly 200 substitution orders since the early 1980s.[22] During that span, the Staff has developed a variety of standard terms and conditions to support the granting of substitution orders.[23] The current terms and conditions, most of which have been in place for decades and which address investor protection and public policy considerations, would apply to the Substitutions as described in the Application.

In addition, the Staff has for decades required applicants to provide (a) a narrative explanation of their reasons for requesting a substitution, (b) a narrative explanation comparing the investment objectives, principal strategies, and principal risks of each existing and replacing fund involved in the substitution, and (c) side-by-side or similar comparisons of the fees, expenses, performance history, net assets, and advisers and sub-advisers of the existing and

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[21] S. Rep. No. 184, 91st Cong., 1st Sess. 41 (1969), reprinted in 1970 U.S.C.C.A.N. 4897, 4936.

[22] Notice of Application, p. 11.

[23] Notice of Application, p. 14.

replacing funds.[24] As every substitution applicant knows, the Staff evaluates these and other relevant factors in determining whether to approve substitutions. In most instances, one or more amendments are filed in response to Staff comments. The Substitutions have undergone that long-standing and well-travelled process.

D. Each Substitution Satisfies the Standards in Section 26(c)

As the Commission has recognized, insurance companies have offered variable insurance contracts with numerous investment options "with the expectation and understanding that they would have the ability to make substitutions in appropriate circumstances."[25] Section 26(c) requires the Commission to approve a substitution as long as the Commission has determined that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act.

Allianz submits that the information contained in the Application demonstrates that each proposed Substitution meets all of the conditions and standards for a Commission order of approval pursuant to Section 26(c).

The terms and conditions of the Substitutions are consistent with the purposes of Section 26(c) and do not entail any of the abuses that Section 26(c) is designed to prevent. The Substitutions will not result in the type of costly forced redemption that Section 26(c) was intended to guard against and, in view of the terms and conditions stated in the Application, are consistent with the protection of investors and the purposes fairly intended by the 1940 Act.

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[24] *See, e.g.,* The Guardian Insurance & Annuity Company, Inc., et al., Rel. No. IC-33594 (Aug. 20, 2019) (order) (File No. 812-14911) [hereinafter, Guardian]; Lincoln National Life Insurance Company, et al., Rel. No. IC-30517 (May 14, 2013) (order) (File No. 812-14063) [hereinafter, Lincoln]; AIG SunAmerica Life Assurance Company, et al., Rel. No. IC-27555 (Nov. 17, 2006) (order) (File No. 812-13300); and Great-West Life & Annuity Insurance Company, et al., Rel. No. IC-24272 (Jan. 31, 2000) (order) (File No. 812-11584).

[25] Notice of Application, p. 14, at text accompanying note 18.

IV. The Advisers' Opposition to the Substitutions

The Advisers' Hearing Request contains numerous mischaracterizations[26] of the facts contained in the Application, the effects of the proposed Substitutions, and the review standards applicable to substitution applications under Section 26(c). Allianz respectfully submits that the Advisers' objections should be rejected by the Commission as discussed below.

The Advisers' Self Interest Is Not Protected by Section 26(c) and Contravenes the Investor Protection Mandate. By their own admission, the Advisers' only interest in the Application is their anticipated loss of advisory fee revenue. Specifically, in asserting its standing to request a hearing the Advisers claimed that "[i]f Allianz is permitted to replace FTVIPT Funds with proprietary funds, the Advisers will suffer a specific and material harm because they will lose significant advisory fee revenues."[27]

Allianz respectfully submits that the Advisers' anticipated loss of revenue is not an interest that Section 26(c) was designed to protect. As the Commission noted in the Notice of Application, "[t]here is no indication in the legislative history of section 26(c) that Congress was concerned with the impact of the substitution on the [target funds]."[28] Similarly, there is no indication that Congress intended Section 26(c) to protect fund advisers.

Moreover, although the 1966 Staff Report specifically stated that "interested ***shareholders*** would…have an opportunity to state their views about the proposed substitution",[29]

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[26] For example, the Hearing Request includes the Advisers' misguided assertions (citing no authority – because no such authority exists), that Section 26(c) requires a "best interest" analysis. (Hearing Request, p. 6, 14.) It plainly does not. The Hearing Request also contains numerous other references to cases (such as *Susquehanna*) (Hearing Request, pp. 4-5), Commission releases (such as guidelines for exemptive applications) (Hearing Request, pp. 7-8), and transactions (such as buyout offers) (Hearing Request, p. 9) that are inapposite to an application under Section 26(c). Such references appear to be intended to distract from the issues germane to consideration of a substitution application under Section 26(c).

[27] See Hearing Request, p. 13 (emphasis added).

[28] Notice of Application, p. 15.

[29] 1966 SEC Report at 337 (emphasis added).

it did not express any concerns for the commercial self-interest of non-investors such as the Advisers.

Furthermore, even if the Advisers' self-interest were a Section 26(c) consideration, which it is not, such self-interest cannot override the contractual rights retained by Allianz, the benefits of the Substitutions to Contract owners, and other factors historically considered by the Commission and its Staff.

As Allianz has previously argued, the Advisers lack standing to challenge the Application because they are not "interested persons" for purposes of Rule 0-5 under the 1940 Act, and they do not have any interest in the Application of a type that entitles them to challenge the Application in any way.[30]

Replacement Funds Sub-Advised by Unaffiliated Managers. Five of the target funds Allianz seeks to replace are series of FTVIPT ("Franklin Funds"). The Advisers complain that the replacement funds are managed by an affiliate of Allianz.[31] However, the replacement funds in four out of the five Substitutions involving the Franklin Funds are sub-advised by either BlackRock Investment Management, LLC, or Fidelity Institutional Asset Management (FIAM LLC), neither of which is affiliated with Allianz. Further, the fifth such fund, while managed by an affiliate, is a fund of funds, the underlying holdings of which are sub-advised by a non-

[30] Letter from Allianz to Vanessa Countryman, dated January 23, 2020, submitted by Carlton Fields, P.A.

[31] Hearing Request, p. 2.

affiliate. Allianz also notes that substitutions to affiliated funds are not inconsistent with Section 26(c), and there is ample precedent for such substitutions.[32]

The Substitutions Are Consistent with the Purposes Fairly Intended by the Policy and Provisions of the 1940 Act. The Advisers allege that the Substitutions are not consistent with the policy and provisions of the 1940 Act and cite to the general policy reflected in Section 1(b)(2) of the 1940 Act.[33] Allianz submits that the Substitutions are consistent with the policies and provisions of the 1940 Act (including the policy reflected in Section 1(b)(2)) because, as described more fully in Parts II and III above, (i) the Substitutions will not result in the type of costly forced redemption that Section 26(c) was designed to guard against, (ii) the terms and conditions of the Application address investor protection and public policy considerations that are appropriate to substitutions, and (iii) the Substitutions will provide benefits to Contract owners. Allianz also notes that Section 26(c) itself embodies an express Congressional policy to accommodate substitutions that meet the requirements of that Section, which the Substitutions do. As the Commission stated in the Notice of Application:

> [T]he Commission believes any section 1(b)(2) concern is addressed by the standard terms and conditions of the substitution orders under section 26(c), including those in the Allianz application. These terms and conditions serve as a check on the insurance company's actions in replacing the mutual funds underlying its separate account UIT, and are designed to help investor protection. The Commission notes that insurance companies have offered separate account UITs with numerous investment options with the expectation and understanding that they would have the ability to make changes among the investment options in appropriate circumstances.[34]

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[32] *See, e.g.*, Guardian, *supra* note 24; AXA Equitable Life Insurance company, et al., Rel. No. IC-33224 (Sept. 11, 2018) (order) (File No. 812-14831) [hereinafter, AXA Equitable]; Commonwealth Annuity and Life Insurance Company, et al., Rel. No. IC-32644 (May 23, 2017) (order) (File No. 812-14646) [hereinafter, Commonwealth]; MetLife Insurance Company of Connecticut, et al., Rel. No. IC-31023 (Apr. 22, 2014) (order) (File No. 812-14221) [hereinafter, MetLife]; Lincoln, *supra* note 24; Nationwide Life Insurance Company, et al., Rel. No. IC-28815 (Jul. 8, 2009) (order) (File No. 812-13495) [hereinafter, Nationwide]; John Hancock Life Insurance Company, et al., Rel. No. IC-27781 (Apr. 16, 2007) (order) (File No. 812-13318) [hereinafter, John Hancock]; and ING USA Annuity & Life Insurance Company, et al., Rel. No. IC-27052 (Aug. 30, 2005) (order) (File No. 812-13148).

[33] Hearing Request, p. 8.

[34] Notice of Application, p. 14 (citations omitted).

Separately, the Advisers claim there is no evidence in the Application that the Contract owners will benefit from the Substitutions, even though the terms of Section 26(c) do not require such a finding. On the contrary, the Substitutions will provide significant benefits to Contract owners, as described in Part II above and in the next section below.

The Advisers also speculate that "[t]he Staff itself seems conflicted about substitutions" and inexplicably quote from two Staff speeches discussing *buyout offers*.[35] Buyout offers have nothing to do with fund substitutions, and Section 26(c) does not apply to buyout offers.

Benefits to Contract Owners. The Advisers claim that the "Application fails sufficiently to identify any significant benefits for investors, other than a temporary [two-year] fee waiver."[36] The Advisers' claim is inaccurate. As discussed in Part II above, the Application describes a variety of significant benefits to Contract owners including, without limitation:

- replacement funds with lower management fees,
- replacement funds with lower total fund expenses (26 basis points lower, on average),
- similar replacement funds managed by well-known advisers and favorable performance histories,
- no cost or expense of Substitutions borne by Contract owners, and
- free transfer rights.

[35] Hearing Request, p. 9.

[36] Hearing Request, p. 12.

Regarding the two-year fee cap referenced by the Advisers, this is a standard condition required by the Commission for substitution applications.[37] Pursuant to this condition, applicants typically agree that for two-years the net expenses of each replacement fund will be no higher than the net expenses of the corresponding target fund. However, in the case of the Substitutions, because the net expenses of the replacement funds are already the same or lower (in most cases ***significantly lower***) than the net expenses of the target funds, the Substitutions will provide benefits that ***exceed*** the benefit of the standard fee cap condition.

Further, as discussed in Part II above, the ***management fees*** for each replacement fund are the same or lower (in most cases ***significantly lower***) than those of the corresponding target fund. Because fund management fees cannot be increased without shareholder approval, the benefits of lower management fees will persist independent of the two-year contractual fee cap condition in the Application.

No Change in Contractual Rights and Obligations. The Advisers erroneously allege that the Substitutions will "alter the contracts" and "override" Contract owner investment decisions.[38] The opposite is true. In making their arguments, the Advisers disregard the fact that the ability to effect substitutions is a fully-disclosed contractual right reserved by Allianz under the Contracts, and that Contract owners purchase the Contracts on this basis. This contractual right serves as an important basis on which Allianz is able to offer the Contract guarantees.[39]

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[37] *See, e.g.*, Guardian, *supra* note 24; Voya Retirement Insurance and Annuity Company, et al., Rel. No. IC-33586 (Aug. 9, 2019) (order) (File No. 812-14856) [hereinafter, Voya]; AXA Equitable, *supra* note 32; Commonwealth, *supra* note 32; Transamerica Financial Life Insurance Company, et al., Rel. No. IC-32606 (April 19, 2017) (order) (File No. 812-14487) [hereinafter, Transamerica]; New York Life Insurance and Annuity Corporation, et al., Rel. No. IC-32227 (Aug. 23, 2016) (order) (File No. 812-14589); Horace Mann Life Insurance Company, et al., Rel. No. IC-31744 (Aug. 07, 2015) (order) (File No. 812-14336) [hereinafter, Horace Mann]; MetLife, *supra* note 32; Minnesota Life Insurance Company, et al., Rel. No. IC-31028 (Apr. 24, 2014) (order) (File No. 812-14203) [hereinafter, Minnesota Life]; The Northwestern Mutual Life Insurance Company, et al., Rel. No. IC-30690 (Sept. 18, 2013) (order) (File No. 812-14128); and Lincoln, *supra* note 24.

[38] Hearing Request, p. 2.

[39] Notice of Application, p. 14 at note 18.

The Advisers also mischaracterize the general purpose and effect of substitutions. As the Commission is aware, variable insurance contracts are long-term investments, and the general purpose and effect of substitutions is to periodically update these contracts with modern, lower-cost or better managed investment options, subject to Commission approval. Over time, the Commission's approval of substitutions have generally facilitated a shift to less expensive funds for variable insurance product contract owners.[40]

The Advisers have no legal right or standing to strip Allianz of its contractual rights by preventing Allianz from effecting fund substitutions consistent with Section 26(c). Allianz unequivocally stands behind its obligations under the Contracts. As stated in the Application, the proposed Substitutions are consistent with the terms of the Contracts, and will not alter Allianz's rights or obligations under the Contracts.

Comparability of Fund Strategies. The Advisers argue that certain replacement fund objectives and strategies are "not sufficiently similar" to those of the corresponding existing funds.[41] The differences described by the Advisers do not alter the overriding similarities between the funds involved in the Substitutions, as more fully described in the Application and as discussed below.

Regarding the funds involved in proposed Substitution 2, the Advisers point out that the Templeton Growth VIP Fund is an actively-managed fund whereas the AZL MSCI Global Equity Index Fund is an index fund. Allianz notes that despite the Templeton Growth VIP

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[40] *See, e.g.*, Voya, *supra* note 37; Commonwealth, *supra* note 32; Transamerica, *supra* note 37; Horace Mann, *supra* note 37; MetLife, *supra* note 32; Minnesota Life, *supra* note 37; Lincoln, *supra* note 24; New York Life Insurance and Annuity Corporation, et al., Rel. No. IC-29947 (Feb. 14, 2012) (order) (File No. 812-13903); Country Investors Life Assurance Company, et al., Rel. No. IC-29717 (Jul. 7, 2011) (order) (File No. 812-13865); AXA Equitable Life Insurance Company, et al., Rel. No. IC-29372 (Jul. 29, 2010) (order) (File No. 812-13686); Nationwide, *supra* note 32; RiverSource Life Insurance Company, et al., Rel. No. IC-28575 (Dec. 30, 2008) (order) (File No. 812-13492); and John Hancock, *supra* note 32.

[41] Hearing Request, pp. 11-12.

Fund's status as an actively-managed fund, the Templeton Growth VIP Fund had a 95% correlation to its benchmark index (MSCI ACWI) over the past three years, as of June 30, 2020.[42] Allianz also notes that the funds share substantial similarities. Both funds are global equity funds, both funds invest in a wide range of market capitalizations, and both funds include investments in foreign securities and investments in small- to mid-sized companies as principal risks.

Regarding the funds involved in proposed Substitution 6, the Advisers state that the Franklin Income VIP Fund ("VIP Fund") and the AZL Fidelity Institutional Asset Management Multi-Strategy Fund ("AZL Fund") have different targets for equity and fixed income investments, and that the VIP Fund may invest more in foreign securities than the AZL Fund. Allianz submits that despite certain differences, the funds share substantial similarities. First, both funds seek to maximize income or a high-level of current income, respectively, while maintaining prospects for capital appreciation. Further, both funds are actively-managed funds, both funds invest in a diversified portfolio of debt and equity securities, and both funds disclose foreign risk as a principal risk. Over the prior three-year period ended March 31, 2020, both funds have allocated approximately 40% of their net assets to equity securities and 60% to debt, cash and other income producing securities. Also, for the prior three year period ended March 31, 2020, both funds allocated over 80% of their equity portfolio to large cap companies.[43]

Regarding the funds involved in proposed Substitution 9, the Advisers attempt to promote the virtues of the Mutual Shares VIP Fund relative to the AZL Russell 1000 Value Index Fund by making the following claims:

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[42] Source: Morningstar.

[43] Source for VIP Fund data: Morningstar.

> [the Mutual Shares VIP Fund] is a longer-term, generally contrarian strategy that is ***likely*** to provide significantly different results than an index, has historically tended to ***outperform in falling markets*** and in markets that favor value stocks, and has regularly generated equity returns with lower volatility than the Russell 1000 Value Index. The [AZL Russell 1000 Value Index Fund] is a generic passive value index fund that ***does not offer such potential benefits***.[44]

Regrettably, the recent performance of the Mutual Shares VIP Fund is a valuable reminder of the dangers of predicting future performance. As shown in Part II above, the AZL Russell 1000 Value Index Fund has significantly outperformed the Mutual Shares VIP Fund for each of the 1-year, 5-year and 10-year periods ended June 30, 2020. This includes recent periods of falling markets, in which Mutual Shares VIP Fund did not outperform the AZL Russell 1000 Value Index Fund.

As the Commission stated in the Notice of Application, the target funds and corresponding replacement funds involved in the Substitutions are substantially similar, consistent with prior Commission orders under Section 26(c) for similar substitutions.[45]

Ample Supporting Evidence. The Advisers inaccurately state that "[t]he Application provides no supporting evidence that the Proposed Substitutions [meet the Section 26(c) standards for approval]."[46] In truth, the Application is supported by more than 133 pages of evidence, including, but not limited to:

- 18 pages comparing the funds' fees and expenses, derived from the funds' publicly-filed registration statements;
- 82 pages comparing the funds' investment objectives, strategies, and risks derived from the funds' publicly-filed registration statements;

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[44] Hearing Request, p. 12 (emphasis added).

[45] Notice of Application, p. 12 at note 16.

[46] Hearing Request, p. 7.

- 5 pages of analysis regarding the comparability of the funds using Morningstar data and other independent sources and Allianz's representation regarding the variety of investment options offered under the Contracts;
- 1 page of comparative performance information derived from public information;
- 2 pages describing Allianz's procedures for effecting the Substitutions in compliance with the Commission's standard conditions for Section 26(c) approvals; and
- 2 pages of Substitution order conditions designed to protect Contract owners.

As discussed above, the nature and content of these evidentiary materials are wholly consistent with the nature and content of the evidence that has supported the dozens of other substitution applications reviewed by the Staff and approved by the Commission over the past several decades.[47] The Advisers can ignore the volume of evidence contained in the Application, but they cannot will it away.[48]

No Requirement to Speculate on the Impact of Substitutions on Value of Contract Guarantees. The Advisers insist that, in order to satisfy Section 26(c), the Commission must review and evaluate a Monte Carlo-type analysis that predicts the effect of the Substitutions on the value of various guarantees under the Contracts.[49] The Advisers' demand to engage in such

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[47] Notice of Application, p. 14.

[48] In this regard, we reject the Hearing Request's contention that the words "if the evidence establishes" in Section 26(c) signify a Congressional intent that some greater or different type of evidence is required for the Commission to act favorably on an application under that section than under Section 6(c) of the 1940 Act. (Hearing Request, p. 6 at n. 15.) The Commission findings under either section must be based on one or more forms of evidence, and the presence of this language in Section 26(c) is most reasonably interpreted as reflecting that simple fact. Nor does anything in the legislative history or the Commission's administration of Section 26(c) in any way suggest otherwise. Further, both Sections 17(b) and 57(c) of the 1940 Act also refer to the need for "evidence" to support a Commission order under those sections, without the Commission historically having ascribed to that reference the meaning that the Hearing Request asserts in the context of Section 26(c).

[49] Hearing Request, p. 11.

speculative analysis finds no support in the legislative history of Section 26(c) or in the Commission's consistent administration of Section 26(c) for over four decades.

As noted in the Commission's Notice of Application, calculating how substitutions would affect the value of variable insurance contract guarantees would require reliance on "numerous assumptions and other factors, including estimates of the future performance of the funds involved over varying time frames, and the impact of future performance on the benefit base used to set the insurance guarantees."[50]

Allianz submits that the volume and complexity of information that the Advisers demand necessarily would be further multiplied, because each form of Contract may offer multiple forms of benefits among which Contract owners have chosen.[51] A better performing fund would affect the value of different contract benefits in different and sometimes opposite ways. For example, a better performing fund would tend to ***reduce*** the value of contract guarantees that provide protection against market declines that otherwise would reduce payments (such as income benefits, withdrawal benefits, or death benefits) below guaranteed levels. This result follows from the fact that as a contract owner's account value rises relative to the benefit base of a

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[50] Notice of Application, p. 13.

[51] The information necessary to accommodate the Advisers' demand would appear to require each such set of circumstances to be analyzed separately. Still more complications would be introduced into the calculations by the need to include the effect of any changes in fees for the guarantees that may result.

Moreover, the Hearing Request (at p. 10) recognizes that the "effect of each Proposed Substitution on each benefit varies greatly depending upon factors such as the performance of the fund, frequency of the election of the benefit, and the timing of the exercise of the benefits." Thus, the Advisers appear to believe that Allianz must engage in an owner-by-owner analysis of all the aforementioned factors to support a finding by the Commission (which they also demand) "that the Proposed Substitutions would be in the best interests of all Contractowners." (Hearing Request, p. 3.) The Advisers do not and cannot cite any authority that supports their proposition.

So great are the complexities that it would be wholly impractical to provide, or for the Commission to review and evaluate, the information that the Advisers demand. Nor would such information be very informative, because it would depend on uncertain predictions or assumptions about such matters as how long Contract owners will remain invested in a replacement fund following a substitution, what the performance of the replacement fund and that related target fund will be over that period, how volatile the performance of each fund will be, and various actions that Contract owners may take by way of exercising flexibility as to timing and amount of premium payments, withdrawals, and numerous other features of the Contracts.

guarantee, it becomes less likely that an insurer will need to pay on the guarantee. On the other hand, a better performing fund also would tend to ***increase*** the value of contract guarantees that can reset at higher levels due to favorable investment performance, such as under an annual ratchet guarantee, though any such increase may be reduced by the fact that the contract owner also may incur greater charges for the guarantee following a reset. Many variable annuity contracts and riders include ***both*** the opportunity to increase the guarantee levels due to favorable investment performance, and protection against market declines because the levels of established guarantees are not reduced by adverse performance. Accordingly, even if the Advisers were able to predict the future performance of an investment option, it would not be possible to make a universal statement regarding the effect of a proposed substitution on the value of guarantees under the Contracts.[52]

In any event, regardless of how a replacement fund performs relative to how the related target fund would have performed, the Substitutions will not result in any diminution in the levels of protection provided under the agreed upon terms of the guarantees in accordance with the Contracts.

Further, in support of investor protection, the Commission and its Staff have developed and implemented conditions that require applicants to represent that at the time of the proposed substitutions, the contracts will offer a comparable variety of investment options with as broad a range of risk/return characteristics.[53] Allianz respectfully submits that the Commission's and its Staff's historical standards of review and conditions for approval of substitution applications reflect an appropriate administration of Section 26(c).

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[52] Allianz also notes that the Advisers' focus on the Substitutions' impact on the value of contract *guarantees* is myopic. For example, although lower fees may reduce the value of the downside protection from a guarantee, it is still in the contract owner's interest to have lower fees. Consistent with this observation, the Staff's consideration of substitution applications historically has approached the protection of investors from a broader perspective.

[53] Application, p. 12.

The Advisers also make inconsistent claims regarding the Commission's obligation to assess the volumes of data that the Advisers propose. In response to the Commission's statements in its Notice of Application regarding the difficulty of calculating how substitutions would affect the value of variable insurance contract guarantees, the Advisers state that "[t]he Advisers do not believe it is the Commission's duty to calculate the evidence needed to support the Application."[54] However, one page earlier, the Advisers state that, "the standards of Section 26(c) do not permit the Commission to base its approval on the assertions of the regulated entity."[55] The Advisers' conflicting statements appear to be intended to provide no path for the Commission to approve any substitutions, much less the Substitutions. Fortunately, as described in Part III of this letter, the standards of Section 26(c) do not require this result.

Finally, in evaluating the Advisers' demand for additional evidence, the Commission should consider the fact that the Advisers have been involved in at least eight substitution applications over the past 10 years (both as advisers to target funds and as advisers or sub-advisers to replacement funds).[56] The Advisers have never previously claimed to the Commission that such applications required additional evidence regarding the impact of such substitutions on contract guarantees. Accordingly, the Advisers' current claims to that effect appear disingenuous.

Guidelines for Filing Exemptive Applications Do Not Apply. The Advisers assert that the Application "fails to meet the Commission's current and long-standing evidentiary standards

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[54] Hearing Request, p. 11.

[55] Hearing Request, p. 10.

[56] *See, e.g.,* Guardian, *supra* note 24; AXA Equitable, *supra* note 32; Commonwealth, *supra* note 32; Transamerica, *supra* note 37; Horace Mann, *supra* note 37; Lincoln, *supra* note 24; Pruco Life Insurance Company, et al., Rel. No. IC-30186 (August 29, 2012) (order) (File No. 812-13990); and MetLife Insurance Company of Connecticut, et al., Rel. No. IC-29544 (December 28, 2010) (order) (File No. 812-13816).

for ***exemptive*** applications."[57] For this misguided assertion, the Advisers cite to the Commission's Guidelines for Filing of Applications for Exemption ("Guidelines"), which require applicants to state the "basis for the ***relief*** requested" and justification "for ***removal*** of any statutory protections."[58]

As the Advisers should know, Section 26(c) provides specifically for the Commission to issue orders of "approval," not orders of "exemption." Accordingly, when the Commission grants orders under Section 26(c), the Commission does not provide applicants any "relief" from any statute, and such orders do not result in the "removal of any statutory protections."[59] Therefore, the Guidelines cited by the Advisers are inapplicable and by their terms ill-suited to applications for orders of approval under Section 26(c).

Further, even if the Guidelines were applicable to the Application, the fact that the content of the Application is consistent with the nearly 200 substitution applications previously ***approved*** by the Commission would establish that the Application is consistent with all applicable requirements.

Also, as noted above, the Advisers' have not previously raised any objections to the Commission's review process and approval of at least eight other recent substitution applications in which the Advisers have been involved.[60] Accordingly, the Advisers current claims appear to be motivated purely by the potential loss of advisory fee revenue, rather than any genuine objection to the Commission's historical standards of review for substitution applications.

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[57] Hearing Request, p. 7 (emphasis added by Allianz).

[58] (Emphasis added by Allianz.)

[59] We note the Advisers did not request a hearing related to the Applicants' request for relief from Section 17(a) of the 1940 Act contained in the Application.

[60] *Supra* note 56.

Administrative Record Satisfies Applicable Standards. The Advisers assert that the Commission's Notice of Application relies on "Allianz's unsupported statements" and does not reflect an "independent analysis" by the Commission as required under the Administrative Procedures Act.[61] Here again, the Advisers draw misleading comparisons between the Commission's Notice of Application and the D.C. Circuit Court of Appeals' findings in *Susquehanna.*[62]

The Advisers' assertions have no merit and are contradicted by the administrative record of the Application. The Notice of Application is supported by substantial independently-sourced evidence, is consistent with longstanding historical standards and precedent, and reflects extensive independent analysis by the Commission and its Staff.

First, the Application includes a comparison of each target fund's and replacement fund's investment objectives, principal investment strategies, principal risks, fees, and performance record.[63] This information was sourced from each target fund's and replacement fund's publicly-filed registration statement and/or shareholder reports. The Commission and its Staff have required Allianz to provide this information and make representations regarding these substantive factors as a basis for approving the requested Substitutions.[64] These substantive

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[61] Hearing Request, pp. 4-5.

[62] Hearing Request, pp. 4-5. In drawing such comparisons, the Advisers ignore the fact that unlike the Application (which is supported by overwhelming precedent and reflects 40 years of Commission experience administering Section 26(c)), the *Susquehanna* decision involved Commission approval of a novel rule change proposed by the Options Clearing Corporation ("OCC"). The Advisers also ignore the OCC's status as a self-regulatory organization. Allianz submits that approving the Application consistent with the standards and conditions applied for several decades and to almost 200 other substitution applications cannot be considered "arbitrary and capricious" as claimed by the Advisers. Ironically, through its demands, the Advisers seek to arbitrarily subject Allianz' Application to review standards that differ substantively from the standards the Commission has historically applied to other substitution applications (including those that benefitted the Advisers). Allianz believes that all Section 26(c) substitution applications should be subject to consistent standards for approval.

[63] Application, pp. 19 and 31-131.

[64] Notice of Application, p. 14.

factors have developed over the decades as a result of the Commission's and Staff's independent analysis of the factual basis for approving substitution applications.

Second, the administrative record includes the Staff's comments on the Application, and Allianz's revisions to the Application in response thereto.

Third, the substance of the Application, including all of the terms and conditions of the Application, reflect the Staff's consistent historical administration of substitution applications based on the Staff's cumulative experience developed in reviewing almost 200 substitution applications over the past several decades.[65]

Fourth, the administrative record reflects the Commission's consideration of issues raised by the Advisers in the Advisers' prior letters to the Commission regarding the Application.[66]

Accordingly, the administrative record reflects that both the Commission and its Staff have invested substantial time and resources and have engaged in a rigorous review of the issues in light of the applicable standards for approval under Section 26(c), consistent with the Congressional intent of Section 26(c) and the legal rights and benefits of substitutions.

The administrative record clearly shows that the Commission and its Staff have committed substantial resources to developing, evaluating, and applying terms and conditions for approval of substitution applications (including the Application) and that the requirements of the Administrative Procedures Act have been fulfilled. Notably, in view of the similarities among the terms and conditions of substitution applications, by asserting that the Commission has not satisfied the standards of the Administrative Procedures Act with respect to the Application, the Advisers effectively seek to call into question the validity of all of the nearly 200 substitution applications previously approved by the Commission.

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[65] Notice of Application pp. 11 and 14.

[66] Notice of Application pp. 10-19.

V. Conclusion

Each of the proposed Substitutions is consistent with the protection of investors and the policy and provisions of the 1940 Act and meets all of the conditions and standards for a Commission order of approval pursuant to Section 26(c).

As described herein, the Substitutions will benefit Contract owners and are supported by overwhelming precedent spanning decades.

The Advisers' criticisms regarding the Application, the Commission's review of the Application, and the appropriateness of approval under Section 26(c) are incorrect and unfounded and are fueled by their own admitted self-interest. Further, the Advisers are not "interested persons" for purposes of Rule 0-5 under the 1940 Act and have no other interest entitling them to challenge the Application.

The Commission and its Staff have conducted a thorough and independent analysis of the Application for over three years, and the Advisers should not be allowed to further delay the Substitutions.

Allianz respectfully requests that the Commission promptly issue an order approving the Substitutions.

Allianz Life Insurance Company of North America
Allianz Life Insurance Company of New York

By: 

Chip Lunde
Carlton Fields, P.A.
1025 Thomas Jefferson Street, NW
Suite 400 West
Washington, DC 20007-5208
Phone: 202.965.8139
Email: clunde@carltonfields.com

Dated: July 31, 2020

CERTIFICATE OF SERVICE

I, Chip Lunde, an attorney at law representing Allianz Life Insurance Company of North America and Allianz Life Insurance Company of New York as applicants for an order of approval and exemption from the U.S. Securities and Exchange Commission under the Investment Company Act of 1940, as amended, File No. 812-14722, hereby certify that, on July 31, 2020, I caused a true and correct copy of the foregoing Written Statement to be served by e-mail delivery and Federal Express to:

Thomas S. Harman (at thomas.harman@morganlewis.com)
Partner
Morgan, Lewis & Bockius LLP
1111 Pennsylvania Ave. NW
Washington, DC 20004

as attorneys for Franklin Advisers, Inc., Franklin Mutual Advisers, LLC, and Templeton Global Advisors Limited.

Dated July 31, 2020

Chip Lunde

Chip Lunde, Esq.
Carlton Fields, P.A.
1025 Thomas Jefferson Street, NW
Suite 400 West
Washington, DC 20007-5208
Phone: 202.965.8139
Email: clunde@carltonfields.com