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

CARLTON FIELDS

Atlanta
Hartford
Los Angeles
Miami
New York
Orlando
Tallahassee
Tampa
Washington, DC
West Palm Beach

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

August 4, 2017

VIA HAND DELIVERY AND EMAIL

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

Re: Response to Letters from Franklin Advisers Inc., et al to the Commission Staff Regarding the Application of Allianz Life Insurance Company of North America, et al. (collectively, the "Applicants") for an Order of Substitution (File No: 812-14722)

Dear Ms. Crovitz,

On behalf of Allianz Life Insurance Company of North America, and Allianz Life Insurance Company of New York (together, "Allianz"), we are submitting this response to letters dated May 10, 2017 ("May 10 Letter") and June 8, 2017 ("June 8 Letter,")[1] from outside counsel to Franklin Advisers, Inc., Franklin Advisory Services, LLC, Franklin Mutual Advisers, LLC and Templeton Global Advisors Limited (collectively, the "Advisers") to the Commission staff (the "Staff") regarding the above-referenced application ("Application").[2]

The Advisers' letters are factually inaccurate and substantively without merit. Among other things, the Advisers' letters reflect a fundamental lack of understanding of: variable insurance contracts, an insurance company's contractual rights of substitution, the legislative history of Section 26(c), and the Commission's administration of substitution requests for over 40 years. We are submitting this letter to respond to these inaccuracies and baseless assertions.

---

[1] Allianz and Carlton Fields did not receive an initial copy of the May 10 Letter, despite the fact they were both shown as "carbon copied" on the May 10 Letter. Allianz and Carlton Fields received the June 8 Letter on June 8, 2017 via e-mail. Allianz and Carlton Fields requested and received the May 10 Letter on June 9, 2017.

[2] Applicants filed an initial substitution application ("Initial Application") on December 7, 2016. Applicants received comments from the Staff on the Initial Application on April 4, 2017. Applicants submitted an amended and restated substitution application ("Amended Application") on May 31, 2017, in response to the Staff's comments. Unless otherwise indicated, all capitalized terms used herein have the same meaning as defined in the Application.

I. Response to Advisers' May 10 Letter

A. Section 26(c) Legal Standard and Legislative History

The May 10 Letter mischaracterizes the legal standard of Section 26(c) in several important respects. First, the May 10 Letter repeatedly asserts – without authority – that Section 26(c) requires the Commission to make a finding that a substitution be in the "best interests" of investors.[3] It plainly does not. To try to overcome this clear lack of authority, the May 10 Letter misleadingly attempts to conflate the concept of "best interests," which it does not define, with the protection of investors standard set out in Section 26(c).[4] To our knowledge, in over 40 years of administering Section 26(c), the Commission has never required a finding of best interests as a basis for issuing a substitution order.[5] No provision of the Investment Company Act of 1940 ("1940 Act") requires the Commission to make such a finding.

Second, the May 10 Letter draws a false analogy between the Commission's proxy rules and Section 26(c). Specifically, the Letter states that when a public company that seeks to undergo a "fundamental change," then corporate law "usually" requires shareholder approval thereof.[6] The Letter then attempts to use this irrelevant assertion as the springboard for the claim that "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."[7] This unsubstantiated claim does not square with the language or legislative history of Section 26(c).

As the Staff knows, Section 26(c) was enacted by Congress as part of the 1970 amendments to the 1940 Act. The language and legislative history of Section 26(c) make clear that it is the Commission's responsibility to make an investment decision on behalf of substituted security holders. Section 26(c) does not direct the Commission to seek, or even contemplate that the Commission would seek, security holder approval of any substitution. In this regard, when the Commission recommended to Congress that it amend Section 26 to require Commission approval of any proposed substitution, it advised Congress, among other things, that "security

---

[3] For example, the May 10 Letter states on p. 2: "The Application contains insufficient evidence to support a '***best interests' finding***." (Emphasis added.)

[4] For example, the May 10 Letter states on p. 3: "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."

[5] Although there is no legal requirement to make a finding of best interests, substitution applicants may voluntarily express the belief that a substitution is in the best interests of contract owners. The expression of such belief, however, is neither a condition of the processing of a substitution application nor a condition for the granting of a substitution order.

[6] May 10 Letter at p. 2. It is telling that Advisers' counsel chose to use public companies rather than mutual funds for its "shareholder rights" analogy. This choice was necessitated by the inconvenient contrary fact that most if not all mutual funds organize in jurisdictions that do not require shareholder votes on many significant actions, such as mergers. Furthermore, the 1940 Act itself does not require shareholder votes on changes in investment objectives, policies, and restrictions that are not designated as "fundamental." In addition, the Commission has adopted numerous rules under the 1940 Act that permit significant corporate actions without shareholder votes, *e.g.*, Rule 17a-8, which permits mergers of affiliated companies.

[7] *Id.*

holders in a unit investment trust are seldom in a position to judge the merits of the substituted security."[8]

In recommending that security holders be protected by Commission scrutiny, it did not recommend that they have an opportunity to approve substitutions such as through a proxy process. Congress amended Section 26 in 1970 to make the Commission responsible for exercising its judgment in place of that of security holders, *i.e.*, to make a unilateral decision. In the course of so doing, it did not impose any requirement to "undertake and document" a "rigorous" public interest finding. And it most certainly did not require the Commission to make a "best interests" finding in the manner of a fiduciary. Rather, the Commission is only required to find that a substitution is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act, which finding is amply supported by the administrative record for the Application as discussed therein and below.

B. Administrative History of Section 26(c)

The May 10 Letter ignores the longstanding administrative history of Section 26(c) and the standards and conditions that the Commission and its Staff have developed over decades of consideration of relevant factors.

The Commission has substantial experience administering Section 26(c), having issued over 200 substitution orders since 1970 to the present. During that span of more than 40 years, the Staff has developed a variety of standards and conditions to support the granting of substitution orders. Current standards and conditions, most of which have been in place for decades and which address investor protection considerations, include the following:

- Ensuring that there is no change in the insurance companies' rights or obligations under the contracts as a result of the substitutions,
- Ensuring that there is no change in tax treatment of contract owners and no tax liability as a result of the substitutions,
- Imposing a two-year, three-year, or permanent expense cap depending on the facts and circumstances,
- Ensuring that no substitution expenses are borne by contract owners,
- Providing pre- and post-substitution notices to contract owners,
- Offering free transfers to different investment options available under the contracts for a minimum of 30 days before and after the substitution,
- Ensuring compliance with any requirements of state insurance regulatory authorities that might apply to the substitutions, and
- Effecting substitutions at relative net asset values.

---

[8] SEC, Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 337 (1966).

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 replacing funds. As every substitution applicant knows, the Staff evaluates these and other relevant factors in determining whether to process a substitution application. In most instances, one or more amendments are filed in response to Staff comments. Applicants have undergone that long-standing and well-travelled process. 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).

We note that Advisers' counsel, Morgan Lewis, appears to have been involved in at least four substitutions recently approved by the Commission.[9] Those applications underwent the same process followed by Applicants here, involved consideration of the same factors as are involved in the Application, and were subject to substantially the same conditions that are enumerated in the Application. Those applications also included several substitutions where the replacement funds are affiliated with the requesting life insurance company applicants, as is the case here, and were each amended multiple times. Accordingly, it is disingenuous for Advisers' counsel to assert in its May 10 Letter that a different standard of review ("best interests"), a different evidentiary record ("full analysis"), and a different legal consideration ("17d-1") should apply here when it obviously did not believe this to be the case when it assisted other life insurance companies in seeking substitution orders on the same basis that Applicants are seeking here.

In view of the legal standards and legislative and administrative history of Section 26(c), Allianz submits that the Commission and its Staff should reject the inaccurate and contradictory assertions made by Advisers' counsel in its May 10 Letter.

C. Effect of the Substitutions on the Value of Contract Guarantees

The May 10 Letter claims that "[t]he value of investors' guarantees will be diminished."[10] In support, however, the Advisers offer up only unsubstantiated, contradictory, and speculative statements.

Among other things, the Advisers claim, without support or analysis, that "[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."[11] This claim reflects a fundamental lack of

---

[9] Transamerica Advisors Life Insurance Company, et al. (File No. 812-14488) and (File No. 812-14490) (the "TALIC applications"), and Transamerica Financial Life Insurance Company, et al. (File No. 812-14487) and (File No. 812-14489) (the "TFLIC applications"). The orders for the TFLIC applications were granted on March 24, 2017, and the orders for the TALIC applications were granted on April 19, 2017.

[10] May 10 Letter at p. 3.

[11] *Id.*

understanding of how guarantees work under variable annuities. First, a guarantee does not "produce income" much less "more income" merely because a contract owner has the ***ability to select*** an actively-managed fund. A given level of investment performance – whether positive or negative – over a relevant period will translate into the same payouts under the Contract guarantees, regardless of whether that performance is earned by an actively-managed fund or an index fund that replaces it.

Second, 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 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. As the Staff knows, 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.[12] Allianz also notes 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. Accordingly, the Contracts will allow Contract owners the opportunity to pursue investment strategies consistent with their investment objective.

The Advisers also claim, again without support or analysis, that "[w]hen 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." This claim reflects the same fundamental misunderstanding of how guarantees under a variable annuity work. First, the mere fact that a substitution involves replacing an actively-managed fund with an index fund will not, by itself, "lower the payout ceiling." Second, as noted above, the performance of an underlying fund would impact different variable annuity contract benefits and guarantees differently. Lower performance would tend to decrease the value of Contract guarantees that can reset higher due to investment gains, and also increase the value of Contract guarantees that provide protection against market losses. Moreover, the amount of charges for a guarantee also may change, and this would have to be considered in any analysis of how a guarantee's value changes. Accordingly, the Advisers' claims regarding the effect of a proposed substitution on the value of guarantees under the Contracts are misplaced and wholly incomplete.

---

[12] 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 more balanced perspective.

Regardless, the premise of the Advisers' claims is that index funds that seek to replicate the performance of the index will not perform as well as actively-managed funds that seek to outperform the index. That premise, however, is speculative. Further, it is a serious oversimplification for the Advisers to point to the benefits that owners might gain if an actively-managed fund outperforms its benchmark without also recognizing the detriment to them if that fund underperforms its benchmark. Perhaps most importantly, speculation regarding future fund performance has not historically been an element of the Staff's consideration of substitution applications -- nor should it be.

The Advisers also impugn the motives of Allianz by speculating that it is seeking the Substitutions in order to pay less on Contract guarantees. Yet, as noted above, Allianz cannot change the guarantees contained in the Contract and Contract riders. As a result, the intrinsic value of such guarantees will remain exactly the same both before and after the substitution. In addition, notwithstanding the Advisers' false and defamatory statements regarding Allianz's interest and desire to honor its commitments under its Contracts, Allianz unequivocally stands behind its obligations under the Contracts. As stated in the Application, the proposed Substitutions will not alter Allianz's rights or obligations under the Contracts.

The Advisers' claims also fail to recognize that the ability to effect substitutions is a contractual right reserved by Allianz under the Contracts, and this contractual right serves as an important basis on which Allianz is able to offer the Contract guarantees. 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).

The Advisers' May 10 Letter also offers uninformed speculation regarding Allianz's statement in the Application regarding the effect of the Substitutions on the value of the benefits offered by the guarantees, and urges the Staff to ask Allianz to explain how the Substitutions will affect the guarantees under the Contracts. The Advisers and their counsel may be unaware,[13] but the Staff, to its credit, has already engaged in precisely the type of inquiry that the Advisers now request of the Staff. Specifically, Allianz, along with other applicants, submitted a previous substitution application on November 16, 2015 (File No. 812-14580) ("2015 Application").[14] In connection with the Staff's review of the 2015 Application, the Staff asked Allianz for a detailed analysis of how the proposed substitutions might affect the value of the variable contract guarantees.[15] In response to the Staff's comment, Allianz engaged its legal, business and actuarial teams to review the Staff's questions. Carlton Fields, as counsel to Allianz, discussed the Staff's questions and concerns with seven (7) members of the Staff, including senior members of the Staff in the Division of Investment Management and two quantitative analysts.

---

[13] We note that Morgan Lewis was involved in other recent substitution applications that include the very same statement that it now appears to question. *See, e.g.*, Second Amended and Restated Application by Transamerica Financial Life Insurance Company et al., filed on July 1, 2016 (File No. 812-14487) [hereinafter, Transamerica Application].

[14] Allianz Life Insurance Company of North America, et al., Investment Company Act Release No. 32207 (Aug. 3, 2016) (notice); Investment Company Act Release No. 32242 (Aug. 29, 2016) (order) File No. 812-14580.

[15] The Staff also engaged on this issue with other applicants seeking substitution orders.

The discussion covered issues such as the pricing of insurance product guarantees and the variables that may affect the future value of guarantees. Allianz, after detailed analysis by its actuaries, supplemented this discussion by providing to the Staff a written analysis regarding the impact of the Substitutions on the guarantees. Ultimately, the statement included in the 2015 Application and the current Application was the result of a thorough and considered analysis of these issues by the Staff. Accordingly, we submit that the Staff has already performed a comprehensive analysis of the issues now raised by the Advisers.

D. The Substitutions Do Not Require Relief Under Rule 17d-1

Without citing any support or providing any analysis, the May 10 Letter asserts that the Substitutions meet the definition of a "joint enterprise or other joint arrangement or profit-sharing plan" under Rule 17d-1 under the Act and that relief under that rule is therefore required because of the affiliation between the Destination Funds and Allianz. If this were true, however, Rule 17d-1 relief would seem to be required for any substitution transaction in which the destination fund is advised by an affiliate of the insurance company. On the contrary, however, over several decades, the Commission has approved dozens of substitutions to affiliated funds without, to our knowledge, ever asserting the applicability of Rule 17d-1. Indeed, even Advisers' counsel, Morgan Lewis, recently assisted in the preparation of several substitution applications involving substitutions to affiliated funds without seeking exemptive relief under Rule 17d-1.[16] No matter, as exemptive relief under Rule 17d-1 is not required.

Under the joint transaction definition of Rule 17d-1(c), such relief would be required only if the Destination Fund has a "joint or joint and several participation, or share in the profits" of the Substitutions. Characteristically, such joint participation/share in profits for Rule 17d-1 purposes have arisen from the management, deployment, or use of a registered investment company's assets.[17] Here, however, the only means by which a Destination Fund will "participate" in a Substitution transaction is through the issuance of its shares in consideration of cash or in-kind contributions deriving from the redemption of the Target Fund's shares. Participation in this type of transaction may properly be subject to Section 17(a),[18] and, with respect to any in-kind contributions, the Applicants have, consistent with historical precedent, requested relief from Section 17(a). However, a Destination Fund's participation in a Substitution will not arise from the management, deployment, or use of the fund's assets in the manner that generally has been characteristic of transactions deemed to require Rule 17d-1 relief.

---

[16] *See* note 9, *supra.*

[17] *See* SEC v. Midwest Technical Dev. Corp., [1961-1964 Transfer Binder] Fed. Sec. L. Rep.(CCH) ¶ 91,252 (D. Minn. 1963) (affiliate front running of fund portfolio transactions); Imperial Financial Services, Securities Exchange Act Rel. No. 7684 [1965 Transfer Binder] Fed.Sec. L. Rep.(CCH) ¶ 77, 287 (Aug. 26, 1965) (affiliate investing simultaneously with fund portfolio transactions); SEC v. Talley Indus. Inc., 399 F.2d 396 (2d Cir. 1968), *cert. denied,* 393 U.S. 1015 (1969) (simultaneous investment in portfolio securities by fund and its affiliate); SMC Capital, Inc. (SEC Staff Letter, Sept. 5, 1995) ("bunching" of fund portfolio transactions).

[18] Section 17(a) prohibits the purchase or sale of securities or other property between affiliates, except for securities of which the buyer or seller is the issuer. The Commission cannot, by rule, prohibit a transaction that is expressly permitted by statute. Accordingly, Rule 17d-1 cannot prohibit transactions permitted by Section 17(a) or, for that matter, fund of fund arrangements permitted by Section 12(d)(1)(G).

Rule 17d-1's inapplicability is demonstrated not only by the Commission's above-mentioned historic practice in connection with Section 26(c) substitutions, but also by the longstanding treatment of a number of very analogous types of transactions. For example, Rule 17d-1 relief is not required for a "fund of funds" to purchase shares of a registered investment company advised by an affiliate of the fund of funds. Nor is such relief required for a "feeder fund" to invest in a master fund advised by an affiliate of the feeder.

Section 26(c) and, where applicable, Sections 17(a) and (b) provide adequate means for the Commission to fully address the appropriateness of the Substitutions, and no purpose would be served by contorting Rule 17d-1 into also being applicable.

E. Commission Staff Review of Substitution Applications

Allianz also takes issue with the Advisers' characterization that the Commission is issuing substitution orders "without any apparent regard to the issues raised in [the Advisers'] letter." As Morgan Lewis surely is aware, the Staff's review of substitution applications is thorough and rigorous. Despite the Advisers' statements otherwise, in Allianz's experience, the Staff reviews each substitution individually, and provides separate consideration of and comments for each substitution requested.

The conditions for substitution orders have been developed over 40 years to meet the standards under Section 26(c). Despite these well-established conditions, the Staff's review and approval process for substitution applications often takes six to nine months and sometimes over a year to complete. Many substitutions are significantly modified or withdrawn as a result of the Staff's review and comments.[19] In Allianz's experience, the Staff's review of substitution applications reflects a rigorous review of the issues and an application of the standards for approval under Section 26(c), consistent with the Congressional intent of Section 26(c) and the legal rights and benefits of substitutions.

F. Precedent and History of "Mass" Substitutions[20]

The Advisers incorrectly state that 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."[21]

In reality, the precedent for Commission approval of applications involving mass substitutions is longstanding and consistent. We note that the Commission granted the first

---

[19] For example, Allianz withdrew a substitution application in 2012 in response to Staff comments. (*See,* Allianz Life Insurance Company of North America, request for withdrawal dated July 13, 2012 of an application for an order of approval and exemption pursuant to Sections 26(c) and 17(b) filed on May 3, 2011, File No. 812-13898.) Allianz also removed five proposed substitutions from its 2015 Application, and withdrew seven proposed substitutions from its current Application in response to Staff comments.

[20] The Advisers do not define what in their view constitutes a "mass" substitution. For purposes of this analysis, we will consider a "mass" substitution to be one that involves 10 or more substitutions.

[21] May 10 Letter at p. 3.

substitution order involving more than 10 substitutions to Aetna Life Insurance and Annuity Company in 1997.[22] Since 1997, the Commission has approved 27 substitution applications involving 10 or more substitutions. The frequency of such orders involving 10 or more substitutions also has been fairly consistent with 4 orders issued during the five-year period 1997-2002; 10 orders issued 2003-2007; 5 orders[23] issued 2008-2012; and 8 orders issued 2013-present. Accordingly, the Advisers' claim of an increasing trend in so-called mass substitutions is a myth, and the Advisers' concern regarding such substitutions is misplaced. Among other things, these orders have generally facilitated a shift to less expensive funds.

Further, of these 27 mass substitution applications, 24 involved replacement funds that were proprietary, 14 involved replacement funds that were index funds, and 10 involved replacement funds that were both proprietary and index. The number of mass substitutions involving proprietary index replacement funds has been relatively consistent, with 5 orders issued prior to January 1, 2008, and 5 orders issued after January 1, 2008. Accordingly, there is no increasing trend towards mass substitution applications that involve the use of proprietary index funds.

The Advisers also mischaracterize the general purpose and effect of substitutions. As the Staff 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 investment options, subject to Commission approval.

G. Proposed Limitation on Commission Authority Under Section 26(c)

The Advisers state that the Commission "should consider substitutions under Section 26(c) only when an insurer intends to replace a fund that is impaired in some way, in jeopardy of being liquidated, has been subject to fraud or is subject to other unforeseen circumstances."[24] This proposed limitation on the Commission's authority under Section 26(c) has no statutory basis or other legal foundation. The Commission's authority under Section 26(c) is not limited to circumstances of fund impairment, and the Commission has not observed any such limitation in its longstanding administration of Section 26(c).

In adopting Section 26(c), Congress recognized that many unit investment trust depositors contractually reserve the right to make substitutions of the sole security in which they invest and established an approval process that is designed to ensure that this contractual authority is exercised consistent with the protection of investors. The Staff's conditions for substitution orders reflect this intent. The Advisers' proposal that Section 26(c) approval be limited to situations where an underlying fund is impaired is self-serving and finds no support in Section 26(c)'s legislative history. Rather, Section 26(c) requires the Commission to

---

[22] Aetna Life and Annuity Insurance Company, et al., Investment Company Act Release No. 22765 (Jul. 25, 1997) (notice); Investment Company Act Release No. 22794 (Aug. 21, 1997) (order) File No. 812-10722.

[23] There were 8 orders issued 2008-2012 involving 9 or more substitutions.

[24] May 10, 2017 Letter at p. 5.

approve a substitution as long as the Commission has determined that it is consistent with the protection of investors and the policy and provisions of the 1940 Act. The substitution from an existing fund to a replacement fund with the same or lower fees and similar objectives, strategies and risks clearly meets this standard.

II. Response to Advisers' June 8 Letter

The Advisers' June 8 Letter noted that the Amended Application reduces the number of requested Substitutions from twenty-three to sixteen. The Advisers speculate in the June 8 Letter that the purpose of the Amended Application is to reduce Allianz's hedging costs, and this "driving intent" is evidenced by the removal of the proposed substitution of the Franklin U.S. Government Securities VIP Fund and the Franklin Rising Dividends VIP Fund, because these funds are "easily hedgeable."

As the Staff is aware, in the Staff's comment 15 on the Initial Application, the Staff noted certain differences in the strategies of seven Target Funds and the corresponding Destination Funds, and asked for additional information to support the conclusion that the specified Substitutions were consistent with the protection of investors. Allianz removed these seven proposed Substitutions to accommodate the Staff's comment, and for no other reason.

The Advisers have admitted that they have not opposed other substitution applications where they would continue to manage assets of funds offered under the applicants' contracts. The fact is that the Advisers did not object to any prior substitution applications until the applicants effectively sought to discontinue their relationship with the Advisers by applying for an order that would substitute all or substantially all remaining funds managed by the Advisers ("Adviser Funds") from the contracts issued by the applicants. The Advisers appear to want to serve as a gatekeeper of substitutions – not objecting when the Advisers gain assets or will continue to manage funds offered by an insurance company, but blocking substitutions that would result in the replacement of all or substantially all remaining Adviser Funds offered by an insurance company. Allianz notes that if the Staff were to accommodate the Advisers under these circumstances, the result would be that Allianz could never remove its contract owners from the Adviser Funds, while other insurance companies would be free to substitute out of the Adviser Funds (as long as the insurance company's contracts continued to offer other funds managed by the Advisers). This could have the effect of leaving Allianz's contract owners "holding the bag" as the last remaining investors in funds managed by the Advisers. The Commission's longstanding administration of Section 26(c) does not support such a result.

We also submit that all Section 26(c) substitution applications should be subject to uniform and consistent standards and conditions for approval. In seeking to prevent a substitution simply because the Advisers will lose assets under management, the Advisers would have the Commission subject different applications to different approval standards, which would be anti-competitive and contrary to the legislative intent and administrative history of Section 26(c).

* * *

Allianz appreciates the Staff's review and comments on the Application and believes that the Amended Application addresses all of the Staff's comments. The Staff's review of the Application was thorough, extensive, and consistent with the historical administration of Section 26(c). The precedent for approval of the Application is overwhelming. The Advisers' interpretation of Section 26(c) is erroneous, unsupported, and contrary to the interests of contract owners; the Advisers' speculation regarding the Applicants' intent is baseless; and the Advisers' characterization of the Staff's review of the Application is inconsistent with the Applicants' experience and the longstanding and well-documented public record of the Commission's administration of Section 26(c).

As stated in the Application, Allianz submits that each of the proposed Substitutions is consistent with the protection of investors and the policy and provisions of the 1940 Act and supported by applicable precedent. Allianz is eager to effect the proposed Substitutions and stands ready to address any further questions the Staff may have regarding the Application or provide supplemental analysis that would be helpful in processing the Application.

Please direct any additional questions concerning the Application to the undersigned at 202-965-8139.

Sincerely,

Chip Lunde

Chip Lunde
Carlton Fields Jorden Burt, P.A.

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
Erik T. Nelson, Senior Securities Counsel, Allianz Life Insurance Company of North America