

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release no. 34129 / December 4, 2020

In the Matter of :
:
Allianz Life Insurance Company of North America :
Allianz Life Variable Account A :
Allianz Life Variable Account B :
Allianz Variable Insurance Products Trust :
Allianz Variable Insurance Products Fund of Funds Trust :
:
5701 Golden Hills Drive :
Minneapolis, MN 55416-1297 :
:
Allianz Life Insurance Company of New York :
Allianz Life of NY Variable Account C :
:
28 Liberty Street, 38th Floor :
New York, NY 10005-1423 :
:
PIMCO Variable Insurance Trust :
:
650 Newport Center Drive :
Newport Beach, CA 92660 :
:
(812-14722) :
:

ORDER UNDER SECTION 26(c) OF THE INVESTMENT COMPANY ACT OF 1940
("ACT") GRANTING APPROVAL OF SUBSTITUTIONS AND UNDER SECTION 17(b) OF
THE ACT GRANTING AN EXEMPTION FROM SECTION 17(a) OF THE ACT

Allianz Life Insurance Company of North America ("Allianz Life") and Allianz Life Insurance Company of New York ("Allianz NY," together with Allianz Life, the "Insurance Company Applicants" or "Allianz"), their respective separate accounts Allianz Life Variable Account A, Allianz Life Variable Account B, and Allianz Life of NY Variable Account C (collectively with the Insurance Company Applicants, the "Section 26 Applicants"), and Allianz Variable Insurance Products Trust, Allianz Variable Insurance Products Fund of Funds Trust and PIMCO Variable Insurance Trust (together with the Section 26 Applicants, the "Section 17 Applicants" or "Applicants") filed an application on December 7, 2016, and an amended and restated application on May 31, 2017, August 4, 2017, May 31, 2019 and August 13, 2019 ("Application"). The Section 26 Applicants requested an order pursuant to section 26(c) of the

Investment Company Act of 1940 (“Section 26(c)”) to approve the substitutions of shares of certain registered open-end management investment companies (“mutual funds”) offered as investment options to certain variable annuity and variable life insurance contracts issued by Allianz Life and Allianz NY (“Contracts”) and held by the separate accounts, registered under the Act as unit investment trusts (“UITs”), of the Allianz insurance companies, with shares of certain other mutual funds (“Substitutions”). The Section 17 Applicants requested an order under section 17(b) of the Act (“Section 17(b)”) exempting them from section 17(a) of the Act (“Section 17(a)”) to the extent necessary to permit them to engage in certain in-kind transactions in connection with the Substitutions.

On December 20, 2019, a notice of the filing of the Application was issued (Investment Company Act Release No. 33721) (“Notice”). The Notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the Application would be issued unless a hearing was ordered.

On January 14, 2020, Franklin Advisers, Inc., Franklin Mutual Advisers, LLC and Templeton Global Advisors Limited (together, “Franklin”) submitted a hearing request on the Application (“Hearing Request”). Also on January 14, 2020, the independent trustees (“Trustees”) of the Franklin Templeton Variable Insurance Products Trust submitted a letter supporting the Hearing Request (included in the term “Hearing Request”).¹

On July 1, 2020, the Commission issued an order granting a hearing on the Application limited to written submissions.² Subsequently, Franklin and Applicants filed written statements dated July 31, 2020, followed by responsive written statements dated August 17, 2020 (collectively, the “Hearing Submissions”).³

For the reasons discussed below, the Commission has determined that the Substitutions satisfy the standards for an order under Sections 26(c) and 17(b). Therefore, the Commission is hereby granting approval of the Application. The Commission’s determinations on the issues raised in the Application and the Hearing Submissions are summarized below.

¹ Subsequently, Allianz submitted a response to the Hearing Request. Franklin later responded to Allianz’s letter. See letters from Franklin to Vanessa Countryman, dated January 14, 2020 and February 12, 2020, submitted by Morgan Lewis, letter from the Trustees to Vanessa Countryman, dated January 13, 2020, submitted by Schiff Hardin, and letter from Allianz to Vanessa Countryman, dated January 23, 2020, submitted by Carlton Fields, available at <https://www.sec.gov/comments/812-14722/812-14722.htm>.

² Order Granting Hearing and Scheduling Filing of Statements, Rel. No. IC-33916 (Jul. 1, 2020), available at <https://www.sec.gov/rules/ic/2020/ic-33916.pdf>.

³ Letters from Franklin to Vanessa Countryman, dated July 31, 2020 (“Franklin Initial Submission”) and August 17, 2020 (“Franklin Responsive Submission”), submitted by Morgan Lewis, and letters from Allianz to Vanessa Countryman, dated July 31, 2020 (“Allianz Initial Submission”) and August 17, 2020 (“Allianz Responsive Submission”), submitted by Carlton Fields, available at <https://www.sec.gov/comments/812-14722/812-14722.htm>.

I. THE SUBSTITUTIONS ARE CONSISTENT WITH THE PROTECTION OF INVESTORS AND THE PURPOSES FAIRLY INTENDED BY THE POLICY AND PROVISIONS OF THE ACT AS REQUIRED BY SECTION 26(c).

The Section 26 Applicants requested that the Commission issue an order pursuant to Section 26(c) approving the Substitutions. Section 26(c) prohibits any depositor or trustee of a UIT holding the security of a single issuer from substituting the security of another issuer for such security without the approval of the Commission. Section 26(c) provides that the Commission “shall issue an order approving [a] substitution if the evidence establishes that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the Act].”⁴ In the variable insurance context, we interpret this standard to mean that the substitution complies with certain terms and conditions set forth in the substitution application that have been developed over several decades of the Commission’s administration of this provision. In particular, the contract holder should not bear the cost of effecting the substitution, must receive adequate advance notice and an opportunity to switch to another investment option cost-free, and must receive the benefit of certain expense limitations on the replacement fund, among other things. We also look to the legislative history in considering whether this standard has been met. Specifically, legislative history shows that the purpose of Section 26(c) is to protect investors in a single-security UIT from the cost of redeeming and then reinvesting if they are dissatisfied with the substitution of the underlying security.⁵

In addition to providing factual information about the funds being replaced (“Target Funds”) and the replacement funds (“Destination Funds”) – such as fees, expenses, investment objectives, principal investment strategies and principal risks – the Application states several terms and conditions to which the requested relief would be subject. These terms and conditions include, among others:

⁴ 15 U.S.C. § 80a-26(c).

⁵ In amending section 26 of the Act to require Commission approval of substitutions, Congress stated: “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 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.” S. Rep. No. 184, 91st Cong., 1st Sess. 41 (1969), reprinted in 1970 U.S.C.C.A.N. 4897, 4936 (“Senate Report”). See H. Rep. No. 1382, 91st Cong., 2d Sess. 33 (1970).

Additionally, Section 26(c) is based on section 11(c) of the Act, which requires Commission approval for the exchange of securities of one registered UIT for the securities of another UIT. See Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong. 2d Sess. 337 (1966). The purpose of section 11(c) was to protect investors from unnecessary costs. In particular, it was aimed at preventing a predatory practice called “switching”—inducing an investor to exchange their shares of one investment company for the shares of another primarily to obtain additional selling charges from the investor. See H. Rep. No. 2639, 76th Cong., 3d Sess. 8 (1940); S. Rep. No. 1775, 76th Cong., 3d Sess. 7-8 (1940); *Hearings Bef. a Subcomm. of the Comm. on Banking and Currency on S. 3580*, 76th Cong., 3d Sess. 951-957 (1940).

- Under the Contracts, the Insurance Company Applicants reserve the right, subject to Commission approval and compliance with applicable laws, to substitute one of the investment options with another investment option after appropriate notice;
- The prospectuses or statements of additional information for the Contracts contain appropriate disclosure of this right;
- The rights or obligations of the Insurance Company Applicants under the Contracts of affected Contract owners will not be altered in any way;
- All affected Contract owners will be notified about a Substitution at least 30 days before the date the Substitution is effected (“Substitution Date”);
- All affected Contract owners will be permitted to make at least one free transfer of Contract value from the subaccount investing in the Target Fund (before the Substitution Date) or the Destination Fund (after the Substitution Date) to any other available investment option under the Contract for a period beginning at least 30 days before the Substitution Date through at least 30 days following the Substitution Date;
- In each of the proposed Substitutions, the investment objective, principal investment strategies and principal risks of each Target Fund are similar or substantially similar to those of the corresponding Destination Fund; and
- Each Destination Fund’s total net operating expenses will be the same or lower than those of the corresponding Target Fund for at least two years following the Substitution Date.

These terms and conditions are consistent with those of similar prior Commission substitution orders under Section 26(c) and are designed to address investor protection, including protecting variable contract holders (i.e., UIT investors) from the cost of redemption and reinvestment if they are dissatisfied with a substitution.⁶

Based on the Application, including the terms and conditions set forth therein, the Commission has determined that the Substitutions are consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act as required by Section 26(c).

II. THE SUBSTITUTIONS MEET THE REQUIREMENTS FOR AN ORDER UNDER SECTION 17(b).

The Section 17 Applicants requested that the Commission issue an order pursuant to Section 17(b) exempting them from sections 17(a)(1) and (2) of the Act to the extent necessary to permit

⁶ As orders are subject to the terms and conditions set forth in the related applications, a reference to the terms and conditions of an order includes the terms and conditions described in the related application.

them to carry out the Substitutions by redeeming shares issued by each applicable Target Fund in-kind and using the securities distributed as redemption proceeds to purchase shares issued by the applicable Destination Funds (the “In-Kind Transactions”). Section 17(a)(1) of the Act, in relevant part, prohibits any affiliated person of a registered investment company, or an affiliated person of such person, acting as principal, knowingly from selling any security or other property to such registered investment company. Section 17(a)(2) of the Act, in relevant part, prohibits any affiliated person of a registered investment company, or an affiliated person of such person, acting as principal, knowingly from purchasing any security or other property from such registered investment company. “Affiliated person” is defined in section 2(a)(3) of the Act.⁷

At the close of business on the Substitution Date, the Insurance Company Applicants will redeem shares of each Target Fund either in-kind or in cash, or a combination thereof, and use the proceeds of such redemptions to purchase shares of the corresponding Destination Fund, with each subaccount of the applicable Separate Account investing the proceeds of its redemption from the Target Fund in the corresponding Destination Fund. Thus, the proposed transactions may involve a transfer of portfolio securities by each Target Fund to Allianz Life and Allianz NY. Immediately thereafter, Allianz Life and Allianz NY would purchase shares of the corresponding Destination Fund with the portfolio securities and/or cash received from the applicable Target Fund. This aspect of the Substitution may be considered to involve one or more sales by Allianz Life or Allianz NY of securities or other property to the applicable Destination Fund. Based on the affiliations detailed in the Application, these in-kind transactions may be prohibited by section 17(a)(1) and (2) of the Act.

Section 17(b), in relevant part, provides that, notwithstanding subsection (a), any person may file with the Commission an application for an order exempting a proposed transaction from one or more provisions of Section 17(a). Pursuant to Section 17(b), the Commission shall grant such application and issue such order of exemption if evidence establishes that: the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned; the proposed transaction is consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under the Act; and the proposed transaction is consistent with the general purposes of the Act.

Accordingly, the Section 17 Applicants seek relief under Section 17(b) from Section 17(a) for the in-kind purchases and sales of the Destination Fund shares. The Section 17 Applicants submitted that the In-Kind Transactions satisfy the standards for an order under Section 17(b) because: (i) the terms of the proposed In-Kind Transactions, including the consideration to be paid and

⁷ Section 2(a)(3) defines affiliated person as “(A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.”

received, are reasonable and fair and do not involve overreaching on the part of any person concerned because the proposed In-Kind Transactions will comply with rule 17a-7 under the Act, other than the requirement relating to cash consideration (because the In-Kind Transactions will involve portfolio securities of the Target Funds and shares issued by the Destination Funds);⁸ (ii) the In-Kind Transactions will be consistent with the policies of each Target Fund and corresponding Destination Fund as stated in their respective registration statements and reports filed with the Commission; and (iii) the In-Kind Transactions are consistent with the general purposes of the Act because they do not raise any investor protection concerns.

Based on information in the Application relevant to these points, the Commission finds that the Substitutions satisfy the standard for an order under Section 17(b).⁹

III. THE HEARING SUBMISSIONS DO NOT PRESENT INFORMATION THAT CHANGES THE COMMISSION’S CONCLUSIONS.

A. Administrative Procedure Act (“APA”)

Relying on the D.C. Circuit’s decision in *Susquehanna Int’l Grp., LLP v. SEC*, 866 F.3d 442 (D.C. Cir. 2017) and two subsequent Commission orders, Franklin asserts that “[t]he Application and the evidentiary record are facially deficient and lack the requisite data and analysis necessary for the Commission to conclude that the proposed substitutions are consistent with the protection of investors” and contends that the Commission’s approval of the Application accordingly would violate the APA.¹⁰

The Commission disagrees with Franklin’s assertion that the Application and the evidentiary record are facially deficient or that the evidence in the record is lacking to make the necessary determination. The Commission is not, as Franklin suggests, improperly placing “unquestioning reliance” on [the Applicants’] representations.”¹¹ The Commission’s determination that the Substitutions satisfy the standard for a Commission order under Section 26(c) of the Act is based on an evaluation of evidence provided in the Application and through the comment-and-response process between Commission staff and Applicants. As discussed in the Notice and above, that evidence includes the fees, expenses, investment objectives, investment strategies and risks of the Target and Destination Funds. The Commission’s determination is also based on its extensive experience with the terms and conditions of the

⁸ Rule 17a-7 is a conditional exemption from section 17(a) of the Act that permits purchase and sale transactions among affiliated investment companies, or between an investment company and a person that is affiliated solely by reason of having a common (or affiliated) investment adviser, common directors, and/or common officers.

⁹ Applicants’ request for an order under Section 17(b) was not contested during the hearing process.

¹⁰ Franklin Initial Submission, 4-7 (discussing *Susquehanna*; Order Disapproving Proposed Rule Change Concerning The Options Clearing Corporation’s Capital Plan, Exchange Act Rel. No. 85121 (Feb. 13, 2019); and Order Disapproving Proposed Rule Change to Introduce a Liquidity Provider Protection Delay Mechanism on EDGA, Exchange Act Rel. No. 88261 (Feb. 21, 2020)).

¹¹ Franklin Initial Submission, 6.

Substitutions set forth in the Application, as discussed further below. These terms and conditions are not merely “representations” of the Applicants; they are substantive requirements to which the Applicants must adhere in order to rely on this order.

B. Terms and Conditions of the Substitutions

Franklin states that “[t]he terms and conditions applicants and the Commission Staff developed in over 200 substitution orders dealt primarily with instances where there was an underlying issue in a single fund. The terms and conditions of those substitution requests have been copied and pasted into slate-clearing applications, which are substantially different in nature... The Commission cannot simply rely on standard terms and conditions developed under single-fund substitution orders without analyzing the effects and harm these slate-clearing substitutions may have on contract holders.”¹²

Franklin does not define what it means by a “slate-clearing substitution.” In comparing “single-fund substitution orders” and “slate-clearing substitutions,” however, we believe Franklin is trying to distinguish between applications involving multiple substitutions for strategic business reasons and applications involving one or a few substitutions due to unforeseen difficulties in the replaced funds.¹³ The Commission disagrees with Franklin’s assertion that the terms and conditions of Commission substitution orders are protective only in the context of the latter type of application. The terms and conditions of Commission substitution orders are based on the Commission’s extensive experience with prior substitution orders and have been designed to address investor protection and the purpose behind Section 26(c), regardless of the number of substitutions covered by an application or the stated reason for the substitution. The Commission has issued nearly 200 substitution orders under Section 26(c) involving variable insurance contract UIT subaccounts, including many orders for multiple substitutions similar to the order being sought by the Applicants.¹⁴

¹² Franklin Responsive Submission, 3-4.

¹³ See Franklin Initial Submission, 2 (“For at least 20 years following the adoption of amendments to Section 26(c) in 1970, the Commission largely approved fund substitutions involving emergencies or unforeseen circumstances, such as the sudden closure of a fund offered as an investment option... More recently, however, substitutions have occurred resulting from dramatically different circumstances having nothing to do with the underlying funds. These substitutions have instead been driven by the insurance industry’s desire to reduce expenses, as contract benefits have proved more expensive than previously predicted. Instead of replacing one fund or a few funds that encountered some unforeseeable difficulty, these substitutions have eliminated *entire slates* of funds, depriving investors of their original investment choices.”).

¹⁴ See, e.g., The Guardian Ins. & Annuity Co., et al., Rel. No. IC-33594 (Aug. 20, 2019) (order), File No. 812-14911; AXA Equitable Life Ins. Co., et al., Rel. No. IC-33224 (Sep. 11, 2018) (order), File No. 812-14831; Commonwealth Annuity and Life Ins. Co., et al., Rel. No. IC-32644 (May 23, 2017) (order), File No. 812-14646; Allianz Life Ins. Co. of N. Am., et al., Rel. No. IC-32242 (Aug. 29, 2016), File No. 812-14580.

C. Justification for the Substitutions

Franklin makes the following assertions:

- A substitution application “should only be granted where affected investors, including variable contract holders and underlying fund investors, would *demonstrably benefit* from after-the-fact modifications to their investments” and “surely the Commission’s determination that a substitution is ‘consistent with the protection of investors’ would align with the interests of, and benefits to, investors”;¹⁵
- many contract holders and their financial advisers may incur additional expenses due to the contract holders seeking advice from their financial advisers regarding the substitutions;¹⁶
- “the Application ignores the range of effects the proposed substitutions may have on the contractual benefits and guarantees attached to the variable contracts”;¹⁷
- “[t]he loss of economies of scale to contract holders that will result from the transfer of their assets from the Target Funds, some of which are currently quite large, to the Destination Funds, many of which are much smaller, is another consequence of the proposed substitutions that the Insurer has not addressed,” and Allianz should have provided the average age of affected contract holders and the average age of annuitization to support that analysis;¹⁸
- the proposed Substitutions “arise from the commercial objectives of insurance companies and not from any necessity arising from the liquidation, closing, or other exigency in an underlying fund”;¹⁹

¹⁵ Franklin Initial Submission, 4-5; Franklin Responsive Submission, 6.

¹⁶ Franklin Initial Submission, 7-8 (“Many contract holders selected underlying fund options only after discussions with their financial adviser and careful consideration of his or her individual financial situation and goals and risk preferences...If the Commission orders the proposed substitutions and inserts funds that are materially different from the Target Funds...contract holders would likely need to repeat these discussions with their financial adviser, thus increasing expenses and burdens not only for the financial adviser but for the contract holder as well.”).

¹⁷ Franklin Initial Submission, 11-13.

¹⁸ Franklin Initial Submission, 15-16. For example, Franklin asserts that: if the majority of contracts will not start paying out and annuitizing until after two years, the two-year expense cap condition imposed on the Destination Funds “will not benefit shareholders transferred to a smaller Insurer-affiliated Destination Fund when the redemptions, and the associated transaction costs, start to increase”; the “significantly lower asset size of some of the Destination Funds could increase the *pro rata* expense charge for each contract holder and the total expense ratio in the long-term”; and “[i]f the average age of the contract holders is older, meaning they are more likely to begin redeeming, that could also put liquidity constraints on the smaller Insurer-affiliated Destination Funds.” *Id.*

¹⁹ Franklin Responsive Submission, 4.

- there are a number of specific questions the Application should have answered;²⁰ and
- instead of replacing the Target Funds with the Destination Funds, Applicants should “add the Destination Funds as additional investment options.”²¹

Section 26(c) states that “[t]he Commission shall issue an order approving [a] substitution if the evidence establishes that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the Act].” This standard does not equate to a showing of a demonstrable benefit to investors, as Franklin asserts. Determining that a substitution is consistent with the protection of investors and the purposes of the Act generally entails establishing the absence of harm, which is a different analysis than establishing the presence of a demonstrable benefit relative to the *status quo* prior to any substitution. We therefore reject Franklin’s assertions that Section 26(c) requires a substitution to demonstrably benefit investors.

In addition, as Section 26(c) is concerned with the protection of investors, it does not require consideration of the burden on an investor’s financial adviser. Moreover, the purpose of Section 26(c) is to protect investors from selling charges associated with a redemption and subsequent reinvestment, which does not include the cost of personal financial advice that an investor may choose to receive regarding a substitution. To the extent the plain language of Section 26(c) presents any ambiguity as to whether consideration of these factors is required, we note Congress’ stated purpose of Section 26(c): to protect *shareholders of the UIT* who redeem and then reinvest in the case of a substitution from being subject to a new *sales load*.²²

Further, Section 26(c) does not require consideration of the impact on the value of contract guarantees or potential losses of economies of scale. The results of any such analyses would be speculative, and their usefulness in determining whether a substitution is consistent with the protection of investors and the purposes intended by the Act would be questionable. Calculating the impact on the value of contract guarantees would be complex and rely 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. Moreover, the analysis would have to be conducted in the context of hundreds, if not thousands, of funds. Similarly, analyzing the impact of potential losses of economies of scale would involve many assumptions and variables, such as post-substitution size of the Destination Fund, age of the contract holder, age of annuitization, and permutations of contract features.²³ Even if it were possible to predict the impact of all of these

²⁰ Franklin Initial Submission, 10-11. Examples include the number of contract holders affected by the Substitutions, whether the various forms of variable contracts are substantially the same with respect to characteristics such as riders, benefits and options, and the available guarantees for each contract. *Id.*

²¹ Franklin Responsive Submission, 10; *see* Franklin Initial Submission, 4.

²² *See supra* note 5.

²³ The importance of knowing the average age of affected contract holders and the average age of annuitization is overstated by Franklin because the current age of a contract holder is only helpful to the extent that

factors, this analysis would likely find conflicting interests among contract holders (i.e., the impact of investing in a smaller fund would affect different contract holders in different ways due to the aforementioned variables, among other things). In case of doubt, we reiterate what the approval process established by Section 26(c) is meant to protect UIT investors from, which is the cost of redeeming the security subject to substitution and then reinvesting. The purpose of the statute is not to protect investors from any negative impact on the value of their contract guarantees or any potential loss of economies of scale.

Next, Section 26(c) does not require limiting the approval of substitutions to exceptional or exigent circumstances. A substitution need not be restricted to such circumstances in order to be consistent with the protection of investors and the purposes intended by the Act. As noted above, Congress' purpose in enacting Section 26(c) was to prevent a UIT shareholder from experiencing the cost of a redemption and subsequent reinvestment, not to limit substitutions to the circumstances noted by Franklin.²⁴

Section 26(c) also does not specify with particularity what "evidence" must be shown. We therefore disagree that any substitution application must contain answers to the specific questions discussed by Franklin, or that the Commission must analyze these particular items when making a determination under Section 26(c).

As to Franklin's assertion that the Applicants should add the Destination Funds without removing the Target Funds, Section 26(c) includes no requirement that the Applicants or the Commission analyze alternative actions to a substitution. Section 26(c) requires the Commission to evaluate whether a particular proposed substitution is consistent with the protection of investors and the purposes intended by the Act, not how it compares to alternative actions.²⁵

Finally, the Commission reiterates, as stated in the Notice, that: insurance companies offer separate account UITs with numerous investment options with the expectation and understanding that they have the ability to make changes among the investment options in appropriate circumstances; such substitutions are expressly permitted by the Contracts; and the obligations of Applicants under the Contracts will not be altered in any way due to the Substitutions.²⁶

we also know when the contract holder will annuitize, and looking to an historical average age of annuitization is imprecise and highly speculative.

²⁴ See Senate Report, *supra* note 5.

²⁵ In any case, if we were to look at alternative options, we note Applicants' assertion that adding new funds, rather than exercising their contractual right to substitute funds, "would increase the costs of administering the Contracts and...discourage Allianz and other similarly-situated insurers from adding new fund options...". Allianz Responsive Submission, 9-10.

²⁶ Notice, 14, 20 (condition 5). See Allianz Responsive Submission, 10 ("The ability to effect substitutions is a contractual right reserved by Allianz under the Contracts...This arrangement serves as an important basis on which Allianz is able to offer the Contract guarantees.").

D. Different Investment Strategies

Franklin states that “several of the Destination Funds have investment strategies that are insufficiently similar to those of the Target Funds” and “[m]ore analysis is needed to determine how replacing the Target Funds with substantially different Destination Funds will affect the choices available to contract holders and the value of the variable contracts, especially as compared against what was offered to contract holders when they initially invested.”²⁷ Franklin further states that “protection of investor choice was a fundamental purpose of Section 26(c)...”²⁸

The Commission disagrees with Franklin’s suggestion that the replaced fund and its replacement fund must be substantially similar. Determining whether a substitution is consistent with the protection of investors and the purposes intended by the Act does not require any finding concerning any differences or similarities between the replaced security and the replacement security, particularly in the context of variable insurance contracts that offer multiple underlying investment options. As discussed above, the purpose of Section 26(c) is to protect dissatisfied UIT investors from the cost of redemption and subsequent reinvestment, not to dictate the characteristics of an underlying investment option. Notwithstanding, the Commission does recognize that Applicants analyzing the comparability of Target Funds and Destination Funds is consistent with the protection of investors and has included conditions to ensure Applicants have engaged in this analysis.²⁹

Additionally, as discussed above and in the Notice, consideration of a substitution’s impact on the value of contract guarantees is not required under Section 26(c), and the results of such an analysis would be speculative.³⁰ We note, however, that Applicants have represented that the benefits offered by the guarantees under the Contracts will be the same immediately before and after the substitutions, and that at the time of the substitutions the Contracts will offer a comparable variety of investment options with as broad a range of risk/return characteristics.³¹

We also disagree with Franklin’s assertion that protection of investor choice was the fundamental purpose of Section 26(c). As reflected in legislative history, the purpose of Section 26(c) is to protect UIT investors from certain costs, not to prevent the sponsor from changing investment options.³² Although we disagree with Franklin’s assertion, investor choice is

²⁷ Franklin Initial Submission, 13.

²⁸ Franklin Responsive Submission, 7.

²⁹ See Application, 12, 13; Notice, 7-8, 9 (Applicants represent that each Target Fund and its corresponding Destination Fund have similar or substantially similar investment objectives, principal investment strategies and principal risks, and that at the time of the Substitutions the Contracts will offer a comparable variety of investment options with as broad a range of risk/return characteristics).

³⁰ See Notice, 11-13.

³¹ Application, 12.

³² See *supra* note 5.

nonetheless protected by the terms and conditions of this order. Specifically, Contract holders who are dissatisfied with a Substitution have recourse: they can transfer for free and without penalty their Contract value out of the Target Fund and into any other available fund offered under their Contract. In the staff's experience, variable contracts typically offer a wide variety of investment options.³³ The Commission also reiterates that the Substitutions are expressly permitted by the Contracts to which the affected Contract holders agreed.

E. Impact on the Target Funds

Franklin states that "once the assets are transferred from the Target Funds to the Destination Funds, the remaining shareholders in the Target Funds could be harmed."³⁴

Section 26(c) states: "It shall be unlawful for any depositor or trustee of a registered unit investment trust holding the security of a single issuer to substitute another security for such security unless the Commission shall have approved such substitution. The Commission shall issue an order approving such substitution if the evidence establishes that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title."³⁵ Because the statute first refers to the ability of "a registered unit investment trust" to conduct a substitution and then in the very next sentence requires Commission approval of substitutions for the protection of "investors," the Commission infers that the statute is intended specifically to protect investors in the UIT. Any ambiguity is resolved by looking to Congress' discussion in enacting Section 26(c), which clearly refers to the shareholder of the UIT.³⁶ Further, Franklin's argument embodies the perspective that the Commission should focus on the interests of third-party investors when administering Section 26(c), even if those interests are inconsistent with or adverse to the interests of investors in the UIT that filed the application. Such a perspective is inconsistent with the purpose, and the Commission's administration of, Section 26(c). We therefore decline to extend the determination under Section 26(c) to require the Commission to examine the effects that a substitution may or may not have on the remaining shareholders of any Target Fund.

F. Standing

Franklin asserts that its standing to request a hearing on the Application is "indisputable" and that "the Commission's decision to grant a hearing necessarily concluded that the Advisers are

³³ See, e.g., Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts, Release No. IC-33814 (Mar. 11, 2020), p. 11 note 16. The relief requested in the Application is also subject to the condition that, at the time of the Substitutions, the Contracts will offer a comparable variety of investment options with as broad a range of risk/return characteristics. Application, 12; Notice, 7-8.

³⁴ Franklin Initial Submission, 3.

³⁵ 15 U.S.C. § 80a-26(c).

³⁶ See *supra* note 5.

‘interested persons’ for purposes of contesting the Application.”³⁷ Conversely, the Applicants contend that Franklin is not entitled to challenge the Application.³⁸

In granting Franklin’s Hearing Request, the Commission concluded only that a hearing on the Application was “necessary or appropriate in the public interest or for the protection of investors.” The Commission accordingly did not make any determination about Franklin’s status as an “interested person” within the meaning of section 40(a) of the Act and rule 0-5(c) of the Act. And because the Commission disagrees with the merits of Franklin’s objections, it need not, and does not, reach the issue here.³⁹

* * * * *

The matter having been considered, it is found that the Substitutions are consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

It is also found that the terms of the proposed transactions, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned, and that the proposed transactions are consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under the Act, and with the general purposes of the Act.

Accordingly, in the matter of Allianz Life Insurance Company of North America, et al. (File No. 812-14722),

IT IS ORDERED, under section 26(c) of the Act, that the proposed Substitutions are approved, effective immediately, subject to the conditions contained in the application, as amended.

IT IS ORDERED, under section 17(b) of the Act, that the requested exemption from section 17(a) of the Act is granted, effective immediately, subject to the conditions contained in the application, as amended.

By the Commission.

J. Matthew DeLesDernier
Assistant Secretary

³⁷ Franklin Responsive Submission, 3; Franklin Initial Submission, 1 n.2.

³⁸ Allianz Responsive Submission, 16 (stating that Franklin “do[es] not have any interest in the Application of a type that entitles them to challenge the Application in any way”).

³⁹ Section 40(a) of the Act provides that an order under the Act shall be issued only after appropriate notice and opportunity for a hearing. Rule 0-5(a) under the Act provides that an “interested person” may submit a hearing request within the time specified in the notice, stating the reasons for the request and the nature of his or her interest. Rule 0-5(c) under the Act states that the Commission will order a hearing on a matter, upon the request of an “interested person” or upon its own motion, if it appears that a hearing is “necessary or appropriate in the public interest or for the protection of investors.”