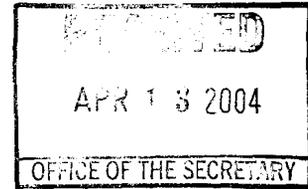


April 12, 2004

Via Hand Delivery

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609



**Re: File No. S7-06-04; Release No. 34-49148
Point of Sale Disclosure and Confirmation Requirements**

Dear Mr. Katz:

These comments on the proposed rules and amendments (“Proposed Rules”) issued by the Securities and Exchange Commission (the “Commission” or the “SEC”) in SEC Release No. 34-49148 (“Release”) are respectfully submitted on behalf of the Committee of Annuity Insurers (the “Committee”).¹ Given the Committee’s mandate, our comments focus solely on the applicability and effect of the Proposed Rules on variable annuity transactions.

The Committee and its member companies endorse the efforts of the Commission to help investors in various types of “covered securities,” including variable annuity contracts, make better-informed decisions by means of enhanced disclosure both at the point of sale and through confirmation statements of the distribution-related costs and conflicts of interests facing broker-dealers selling such covered securities. The Committee recognizes the substantial effort expended by the SEC in crafting a single disclosure regime for a number of complex products (*e.g.*, mutual funds, 529 plans, variable life insurance policies and variable annuity contracts) for use at point of sale and in the confirmation statement process. However, the disclosure regime proposed in the Release, while possibly appropriate for mutual funds, is simply not workable and in many respects not relevant for variable annuities given the significant differences in the structure, distribution channels and the sales compensation arrangements of variable annuities as compared to mutual funds. Accordingly, the Committee is submitting comments intended (a) to provide the Commission with information concerning common distribution and sales compensation practices for variable annuities and (b) to highlight certain aspects of the Proposed Rules warranting clarification or further deliberation.

¹ The Committee of Annuity Insurers is a coalition of life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent approximately half of the annuity business in the United States. A list of the Committee’s member companies is attached as Appendix A. This comment letter addresses variable annuities only, since fixed annuities are not subject to the Proposed Rules.

RESPONSE TO REQUEST FOR INFORMATION CONCERNING VARIABLE ANNUITY DISTRIBUTION AND COMPENSATION PRACTICES

The Committee has noted the Commission's request for information concerning distribution and compensation practices for variable annuities and the Release's numerous requests for comments on how and whether to apply the Proposed Rules to variable annuities.² In response to these requests, the Committee is providing the following information, which is intended to identify some of the ways in which variable annuity transactions differ from mutual fund transactions with reference to the Proposed Rules, as well as to highlight the serious logistical challenges the Proposed Rules would present.

- *Multiple Investment Options.* Most variable annuity contracts offered today are funded by what is sometimes referred to as a "two-tier" investment company structure. The top tier is a separate account established by an insurer and registered with the Commission as a unit investment trust. The separate account itself ordinarily is divided into subaccounts, each investing in the shares of a designated class of shares of an underlying fund ("underlying funds"). The lower tier thus consists of the underlying funds. Most contracts offer 10 or more underlying funds, which may or may not be affiliated with one another. Under current rules, it is customary to include information concerning simultaneous transactions in subaccounts on a single confirmation. For example, a confirmation for the initial sale of a variable annuity will report not only the transaction entailing the issuance of the variable annuity contract but also information reporting the unit value, number of subaccount units and dollar value of the allocation of the initial premium to each selected subaccount.

² For example, the Commission requests comment not just on the substance of the Proposed Rule, but also the "appropriateness" of the Rule's applicability to variable annuities with respect to the following concepts: the general and purchase-specific confirmation disclosure requirements under Proposed Rule 15c2-2 ("[c]ommenters may also wish to discuss whether all of these proposed general disclosure requirements are *appropriate* to transactions in variable annuities.")(69 Fed. Reg. 6438, 6448 (Feb. 10, 2004)(emphasis added)); cost disclosure requirements under Proposed Rule 15c2-2 ("[c]ommenters also may address whether all of these requirements are *appropriately* applied to variable annuities.")(Id. at 6450 (emphasis added)); and the point of sale disclosure generally under Proposed Rule 15c2-3 ("[c]ommenters may also wish to discuss whether the point of sale disclosure requirements of proposed rule 15c2-3 would be *appropriate* to transactions in variable annuities.")(Id. at 6458 (emphasis added)).

- *Subaccount Transactions are not Mirrored in Underlying Fund Transactions.* In the case of most variable annuity contracts, investors allocate their premium payments to available subaccounts and can reallocate their cash value among subaccounts from time to time. Because investor transactions in subaccounts are processed under aggregation and netting rules, an investor's investment in or redemption from a given subaccount does not necessarily result in a purchase or redemption transaction in shares of the underlying fund.
- *Common Structure of Selling Firm Compensation.* With most variable annuity contracts, sales compensation paid to the broker-dealer firm selling a variable annuity contract in the retail market ("Selling Firm") generally consists of one or more of the following: (1) a percentage of the premium payments made for the variable annuity contract; (2) an ongoing "trail" commission based on the overall assets held in the variable annuity contract; and (3) a marketing allowance, which may or may not be calculated with reference to premium payments and/or overall assets held in the variable annuity contract. Ordinarily, the insurer or a broker-dealer firm acting as the principal underwriter ("Principal Underwriter") and/or a wholesaling firm ("Wholesaler") pays part or all of this compensation to the Selling Firm. In addition, the Selling Firm may receive non-cash compensation benefits from the Insurer, Principal Underwriter or Wholesaler, or from the principal underwriter or wholesaler for an underlying fund in the form of contributions to training and education meetings and other similar events.
- *Lack of Relationship Between Charges and Selling Compensation.* With most variable annuity contracts, sales compensation paid to the Selling Firm is not specifically allocated to a particular fee or charge imposed under the variable annuity contract, and therefore sales compensation is not described or identified as such in the prospectus fee table or in the name of any particular charge. Rather, the insurer pays the sales compensation out of its own assets, which include revenues derived from periodic deductions made under the terms of the variable annuity contracts. Further, while most variable annuity contracts provide for a contingent deferred sales charge, this charge, if collected by the insurer, is not paid to a Selling Firm. Thus, in only very rare instances is a charge imposed under a variable annuity contract that is specifically identified for sales compensation. As a final example of the differences between variable annuities and mutual funds, the Committee notes that, since most separate accounts are registered as unit investment trusts, they are not subject to the regulatory framework for plans adopted pursuant to rule 12b-1 of the Investment Company Act of 1940 ("12b-1 plan(s)") and service fees imposed on mutual funds.
- *No Multi-Class Structure.* While variable annuity contracts share certain common characteristics and features, there are no standardized industry conventions

establishing a “class” structure for variable annuities.³ Further, variable annuity contracts offer different combinations of features, benefits and riders that would make it extremely difficult to develop accurate “comparisons” with respect to sales compensation arrangements.

- *Complex and Diverse Sales Processes.* Variable annuities are sold in a wide variety of situations with very different “points of sale.” For example, a variable annuity could be purchased by a corporate employer as the funding vehicle for a retirement plan in a context entailing a “request for proposal” process and negotiations carried out over several months, on a check and app basis by an individual in the context of a financial plan, or through a brokerage account as a rollover distribution. A variable annuity could be recommended in the context of a much broader investment portfolio discussion in which multiple products (*e.g.*, different mutual funds, different variable annuities) may be presented, many of which may trigger separate point of sale disclosure statements under the Proposed Rules. Further, at the point in time that would be deemed to be the “point of sale” under the Proposed Rules’ definition, the amount to be invested and associated costs often are not yet determinable. However, the Proposed Rules presume a simplistic sales process involving the recommendation of a single product and an easily identifiable point of sale.
- *Underlying Fund Sales Compensation.* Most variable annuity contracts are structured to provide for the investment of contract owner premiums in a number of underlying funds. To our knowledge, none of these underlying fund impose any sales charges on purchases or redemptions of their shares, but they may have 12b-1 plans. Fees paid pursuant to a 12b-1 plan may be directed to the insurer or Principal Underwriter for the variable annuity contract. It is uncommon, however, for fees under a 12b-1 plan to be paid directly to a Selling Firm.⁴
- *Integration and Operational Issues with Confirmations.* Because the processing of variable annuity transactions is within the control of the insurer, in virtually all cases, the insurer generates the confirmations on behalf of the Selling Firms. Currently, no industry-wide infrastructure exists to support the delivery or exchange of variable annuity transaction and sales compensation information among insurers, Principal Underwriters, Wholesalers and Selling Firms to facilitate the generation of confirmations for Selling Firms disclosing the items required under the Proposed Rules. The Proposed Rules contemplate a confirmation containing transaction information that could be derived *only from* an insurance company’s processing system (*e.g.*, separate account unit values), as

³ The Committee notes that, in certain circumstances, the variable annuity industry may informally refer to certain pricing structures as “B shares” “L shares,” etc.

⁴ If the Principal Underwriter also serves as a Selling Firm, the 12b-1 fees are more likely to be paid directly to a Selling Firm.

well as conflict of interest information that would be known *only* by the Selling Firm (*e.g.*, comparative payout rates to its representatives). As described below, the Release reflects little consideration of the enormous operational challenges presented by the Proposed Rules.

- *Confirmation Practices.* Many of the variable annuity transactions for which confirmations currently are generated do not implicate any sales compensation arrangements. For example, many variable annuity contract owners elect various reallocation features, such as dollar cost averaging and portfolio rebalancing. In addition, many contracts give contract owners the right to make transfers among subaccounts. These transactions do not have any impact on sales compensation arrangements. Furthermore, the SEC staff has issued a number of no-action letters that address the unique circumstances of confirmations in the context of variable annuity contracts.⁵ These no-action letters provide relief from certain technical confirmation requirements and such relief has not been (but should be) carried forward under the Proposed Rules.

OVERVIEW OF COMMITTEE COMMENTS

The foregoing comments illustrate the areas in which the Proposed Rules would need to be significantly re-worked if the rules are to function in a meaningful way in connection with the distribution and marketing of variable annuities. The Committee firmly believes that, unless the Proposed Rules are substantially modified to provide a relevant and easily-understood framework for the disclosure of the distribution-related costs and conflicts of interest for broker-dealers selling variable annuities, the information provided to potential purchasers of variable annuities will not be helpful and could serve to distract investors from the key information.

⁵ A substantial number of variable annuity principal underwriters have obtained exemptions to permit their use of alternative confirmation statement arrangements. For example, in connection with group annuity contracts funding certain employee benefit plans (principally arrangements under Section 403(b) of the Internal Revenue Code), no-action letters have provided relief from Rule 10(b)-10(d)(6)(iii)(C) to permit insurance company affiliates of broker-dealers to deal directly with employers that take longer than 30 days to remit payroll deductions. *See, e.g.*, Metropolitan Life Insurance Company (pub. avail. Apr. 3, 1995); The Variable Annuity Life Insurance Company (pub. avail. Dec. 20, 1985). SEC staff has also issued no-action letters (many of which were framed as exemptions) related to variable life insurance confirmation practices. *See, e.g.*, New England Mutual Life Insurance Company (pub. avail. Oct. 29, 1983); Providentmutual Variable Life Insurance Company (pub. avail. Mar. 1, 1984); Pruco Life Insurance Company (pub. avail. May 11, 1985); Nationwide Life Insurance Company (pub. avail. Jan. 11, 1987).

The Committee believes that the way to ensure the Proposed Rules are most useful to investors purchasing variable annuities would be to develop rules that are more specifically tailored to the features and characteristics of variable annuities and their distribution and compensation practices. Given the time limitations in preparing this response, and the conceptual nature of the Release, the Committee has not prepared an item-by-item review of the Proposed Rules or an alternative disclosure format. If the Commission does plan to move forward with a disclosure regime that is more targeted to variable annuities, the Committee would be pleased to make specific suggestions on the forms of confirmation statements and point of sale disclosure documents, and even to undertake the effort to provide the Commission with draft forms specifically tailored to variable annuity products.

COMMENTS ON SPECIFIC ASPECTS OF PROPOSED RULES

The remainder of this comment letter focuses on the following aspects of the Proposed Rules:

- The applicability of the proposed disclosure regime of sales loads, asset based charges, revenue sharing, and brokerage commissions to the variable annuity marketplace.
- The requirement that **each** broker-dealer firm that “effects a transaction” provide confirmation information describing the compensation it may receive;
- The content and scope of certain confirmation requirements; and
- The timing and applicability of the point of sale disclosure document for variable annuities.

Variable Annuity Compensation Structures

The Proposed Rules require confirmation statement and point of sale disclosure of sales loads, asset based sales and service fees, dealer concessions, revenue sharing, and portfolio brokerage commissions, as those terms are defined and described under the Proposed Rules. Most of the descriptive information in the Release and in the Proposed Rules related to these disclosure items is derived from practices involving mutual funds, and there is little guidance with respect to how such items should be interpreted in the context of variable annuity transactions.

As indicated above, many of these interpretive issues arise from a fundamental and important distinction between the structure of mutual funds and variable annuities: virtually all variable annuities today are issued through a two-tier investment company

structure.⁶ The complexity and lack of clarity under the Proposed Rules, particularly in light of the two-tier variable annuity structure, is well-illustrated through the proposed disclosure of revenue sharing payments. The variable annuity industry typically uses the term “revenue sharing” to describe inbound payments from the adviser of an underlying fund to the insurance company. These payments become part of the insurance company’s general account assets, and can be retained by the insurer. Unlike with mutual funds, it is rare for any adviser to an underlying fund to make such payments directly to a Selling Firm. The Committee views this as just one of many examples where the Proposed Rules are rife with interpretive issues and could lead to confused and non-uniform disclosure practices.⁷

Other interpretive issues arise from the fact, noted at the outset of our letter, that, in the context of variable annuity contracts, there ordinarily is no direct correlation between the charges assessed against the contract or separate account and the sales compensation paid to the Selling Firm. Sales compensation is paid by the insurer out of its own assets.⁸ In addition, interpretive issues or ambiguities are raised by the general use of mutual fund terminology in the Proposed Rules, not the terminology commonly used in the variable annuity marketplace.

The Committee recommends that the Commission re-work the confirmation statement and point of sale disclosure requirements to reflect the two-tier structure of most variable annuity contracts, the fact that, unlike mutual funds, the source of sales compensation is not directly correlated with charges deducted from the variable annuity contract or the separate account, and the terminology commonly used in the variable annuity marketplace. In doing so, the Committee notes that the focus of the confirmation and point of sale disclosure for variable annuities should be on identifying the typical compensation payments made to Selling Firms.⁹

⁶ We note that the Release observes that some variable annuities do use a single-tier structure. 69 Fed. Reg. 6338, 6342 at n. 26.

⁷ Without going into detail, the treatment of trail compensation, portfolio brokerage commissions, and certain asset-based insurance and expense charges are other examples. The Committee is aware that staff of the SEC is on record as stating that inbound revenue sharing should not be viewed as “revenue sharing” under the Proposed Rules. Nonetheless, based on the definitions of “Fund complex” and “Revenue sharing” under the Proposed Rules, interpretive issues remain.

⁸ The Proposed Rules’ treatment of insurers as issuers seems to be an attempt to recognize this fact, but by treating both separate accounts and insurers as issuers, the proposals could, in effect, operate to require redundant disclosure of charges and sales compensation.

⁹ As described above under “*Common Structures of Selling Firm Compensation*,” Selling Firms often receive one or more of the following: (1) a percentage of premium payments; (2) an ongoing “trail” commission, and (3) a marketing allowance.

Multiple Broker-Dealer Firms Confirming Transactions

Proposed Rule 15c2-2 would apply to “every broker-dealer that effects a transaction in a covered security, including transactions effected by more than one broker-dealer.”¹⁰ Today, customers purchasing variable annuities typically receive a single confirmation from the issuing insurance company, acting on the broker-dealer’s behalf. The Proposed Rules would appear to require disclosure regarding concessions, revenue sharing, etc., with respect to **any** broker-dealer that effects a transaction. This provision could be read to include the Selling Firm, the Principal Underwriter, and any Wholesaler that receives compensation in connection with the variable annuity transaction. This apparently would be the case regardless of whether the purchaser of the variable annuity contract has any contact with the Principal Underwriter or the Wholesaler. The Release states that investors should see information about those types of remuneration specifically attributed to *each* broker-dealer in order to allow investors to evaluate conflicts of interest.¹¹ Given the stated rationale for multiple firm confirmations, it seems illogical to conclude that an investor’s decision making process would be improved as a result of information on the conflicts of interest facing a broker-dealer with whom the investor has no contact (*e.g.*, the Principal Underwriter or Wholesaler).¹²

Imposing the confirmation statement requirements on Wholesalers and Principal Underwriters would require exponentially enhanced coordination and integration of systems among the relevant broker-dealer firms. Assuming the industry comparison information proposal is adopted, the company generating the confirmation will also have to provide Selling Firm-specific information, since Selling Firms will receive different amounts of revenue sharing, portfolio securities transaction commissions and concessions. Selling Firms in the variable annuity industry generally do not have electronic feeds to the issuing insurance company or the Principal Underwriter that allow for the transmission of such data. Unlike the mutual fund industry, which has certain standard electronic feeds available for securities held in a brokerage account, the required infrastructure has not been widely deployed in the variable annuity industry for products purchased on a “check and app” basis. Preliminary review of the potential systems of data exchange indicate that it is unlikely that modifications alone would provide the required functionality, but rather completely new systems would need to be constructed. The Committee notes that the systems requirements to provide this level of information, and the integration of systems between and among Wholesalers, Principal Underwriters, and Selling Firms, is a daunting challenge under the Proposed Rules and will require significant transition time.

¹⁰ 69 Fed. Reg. 6438, 6456 (Feb. 10, 2004).

¹¹ *Id.* at 6457.

¹² The Committee notes that where the Selling Firm and the Principal Underwriter are affiliated, it may make sense to have a prophylactic measure in place under the Proposed Rules to prevent the Principal Underwriter from receiving undisclosed compensation that is used to fund the marketing operations of its affiliated Selling Firm(s).

Finally, the Committee believes that multiple firm confirmation statements will lead to customer confusion. A variable annuity purchaser could receive a dizzying number of confirmation statements resulting from the same variable annuity transaction from the Principal Underwriter, Wholesaler(s) and the Selling Firm, possibly at slightly different times, with each confirmation statement reflecting the different types of compensation received by each firm. The Committee further notes that the Proposed Rules should clarify that broker-dealer firms that are providing compensation information on their confirmation statements should only be reporting the compensation they retain, and not any of the compensation that they may pay to other broker-dealer firms. For example, if the Proposed Rules retain the requirement for the Principal Underwriter to disclose information, the Principal Underwriter should only be required to confirm the compensation that it keeps, and should not report any amounts that it pays to Wholesalers or Selling Firms.

Content of Confirmation Statements

The Committee believes that providing information on confirmation statements identifying charges that are already clearly and prominently disclosed in the prospectus fee table, and also referenced on the point of sale disclosure document, is unnecessary, redundant and potentially confusing to investors.¹³ Rather, it makes more sense for the confirmation statement to focus on the compensation being paid to the Selling Firm, and not on the charges incurred under the variable annuity contract.

The Release also requested comment on whether a single confirmation should be used for transactions in both the variable annuity contract and the underlying funds. The Committee's view is that a single confirmation statement must be used. While the subaccounts of the separate account invest in such underlying funds, an investor's investment in the subaccount is not necessarily reflected as an investment in an underlying fund because of the aggregation and netting of orders occurring at the insurance company level. Since transactions at the underlying fund level do not necessarily correlate to transactions at the subaccount level, disclosure of transactions at the underlying fund level simply would not be possible for each investor's transactions.

Timing and Relevance of the Point of Sale Disclosure Document for Variable Annuities

Under Proposed Rule 15c2-3(a), the point of sale disclosures must be provided at the "point of sale." Proposed Rule 15c2-3(f) defines "point of sale" as (a) immediately prior to the time the broker-dealer accepts the order from the customer, or (b) as to transactions for which the customer does not open an account and in which the broker-

¹³ As noted above, there generally is not the same direct correlation between charges and sales compensation in the context of variable annuities as there is for mutual funds.

dealer does not accept the order from the customer, at the time the broker-dealer first discusses the variable annuity with the customer. For a variable annuity transaction, the "point of sale" will depend on the manner in which the Selling Firm effects the variable annuity transaction, *e.g.*, on a check and app basis or through a securities brokerage account. If a customer has a securities brokerage account with a broker-dealer, the point of sale would be the time the order is communicated to the broker-dealer. For check and app business, the broker-dealer must provide the disclosure at the first time the broker-dealer communicates with the customer about the variable annuity. As described above at "*Complex and Diverse Sales Process*," Selling Firms may be involved in a number of different types of transactions that lead to confusion as to what type of point of sale disclosure must be provided, and when it must be provided.

In addition, the Committee notes that there is tension in the Proposed Rules between providing the point of sale disclosures at the earliest possible time, and attempting to provide purchaser-specific information. In essence, where the amount of the securities purchase is reasonably estimable, the Selling Firm must provide a "mini-illustration" of actual fees and costs to be paid by the purchaser based on the specific amount invested.

The Committee recommends that the timing and mechanics of the delivery of the point of sale disclosure be more completely described in the definition of "point of sale" for the various types of variable annuity transactions. In addition, given the complexity of the sales process, the Committee suggests that only the hypothetical \$10,000 investment be used as the basis for the point of sale disclosure, and not the mini-illustration described above.¹⁴ Furthermore, the Committee strongly recommends that only the initial purchase of a variable annuity contract should trigger an obligation on the Selling Firm to provide a point of sale disclosure document; no point of sale disclosure should be required when additional amounts are invested in a variable annuity contract after the initial purchase.

CONCLUSION

The Committee appreciates the time and resources that the Commission and its staff have devoted to this important initiative, and this opportunity to provide our views to the Commission. We also appreciate your careful consideration of our comments and positions and what we hope is your continued commitment to create a workable

¹⁴ The Committee also notes that state mandated free look rights are available for variable annuity contract purchasers. All investors will receive both the confirmation and the prospectus prior to the conclusion of the free look right. In some states, the purchaser can receive a refund of premium during the free look period. As a result, the need for customer specific point of sale disclosure should be lessened.

Mr. Jonathan G. Katz
April 12, 2004
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disclosure format for the variable annuity industry that will provide meaningful information to investors.

Respectfully Submitted,

Sutherland Asbill & Brennan LLP



By: Susan S. Krawczyk
Eric A. Arnold

FOR THE COMMITTEE OF ANNUITY
INSURERS

Cc: The Honorable William H. Donaldson
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
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APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

Allmerica Financial Company
Allstate Financial
American International Group, Inc.
AmerUs Annuity Group Co.
Equitable Life Assurance Society of the United States
F & G Life Insurance
Fidelity Investments Life Insurance Company
GE Financial Assurance
Great American Life Insurance Co.
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
Life Insurance Company of the Southwest
Lincoln Financial Group
ManuLife Financial
Merrill Lynch Life Insurance Company
Metropolitan Life Insurance Company
Mutual of Omaha Companies
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
The Phoenix Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
Sun Life of Canada
Travelers Insurance Companies
USAA Life Insurance Company
Zurich Kemper Life Insurance Companies