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November 5, 2010

By Electronic Delivery

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

Re: Proposed Rule and Rule Amendments Replacing Rule 12b-1 Under the Investment Company Act of 1940; Release Nos. 33-9128; 34-62544; IC-29367; File No. S7-15-10

Dear Ms. Murphy:

The American Council of Life Insurers ("ACLI") is a national trade association with 300 members that represent more than 90 percent of the assets and premiums of the life insurance and the annuity industry. Life insurers provide both group and individual variable life insurance and variable annuity contracts funded by registered separate accounts organized unit investment trusts ("UITs") under the Investment Company Act of 1940.

Some variable contracts structured as UITs participate in Rule 12b-1 distribution arrangements with underlying mutual funds, which is the focus of the proposal. We greatly appreciate the opportunity, therefore, to share our views on the proposed rulemaking, which would restructure the manner in which mutual fund assets may be used to pay for shareholder servicing and for distribution of mutual fund shares.

I. Summary of the Rule Proposal

On July 21, 2010, the SEC invited comment on a proposal[1] that would rescind Rule 12b-1 under the Investment Company Act of 1940, and replace it with a new framework for "marketing and service fees" and "ongoing sales charges." The proposal would also amend Rule 6c-10 under the investment Company Act to allow mutual funds the option of issuing shares at net asset value to broker-dealers, who could then establish and collect commissions or other sales charges to pay for distribution. The Rule12b-1 initiative contains four basic elements:

- New "marketing and service fees" under proposed Rule 12b-2;

[1] *See* Release Nos. 33-9128; 34-62544; IC-29367; File No. S7-15-10 (July 21, 2010) available at http://sec.gov/rules/proposed/2010/33-9128.pdf .

- New "ongoing sales charges" under amended Rule 6c-10;

- New and revised disclosure requirements related to marketing and service fees and ongoing sales charges; and,

- A new option for “account level sales charges" where mutual funds issue shares at net asset value to broker-dealers, who establish and collect their own commissions and sales charges related to those shares.

According to the SEC's Rule 12b-1 proposal, marketing and service fees may be used to pay:

- Costs associated with participation on a distribution platform, such as a mutual fund "supermarket;"

- Trail commissions to broker dealers in recognition of the ongoing services they provide to fund investors;

- Retirement plan administrators for service provided to participants;

- Salaries, rent and other overhead costs for shareholder call centers;

- Servicing fees such as those currently permitted by FINRA rules; and,

- For other traditional distribution-related services.

Under proposed Rule 12b-2, mutual funds-would be permitted to pay an asset based fee for distribution activities which will be known as a "marketing and service fee." The amount of the fee may not exceed the service fee limit under FINRA Conduct Rule 2830, which is currently limited to 25 basis points annually. In contrast with the general rule, however, which limits the types of expenses that qualify for payment in service fees, marketing and service fee under Rule 12b-2 could be used for any "distribution activity."

Rule 12b-2 would define the term "distribution activity" broadly and in the same manner as it is prescribed in current Rule 12b-1 as "any activity which is primarily intended to result in the sale of shares issued by a [mutual] fund, including... advertising, compensation of underwriters, dealers, and sales personnel, the printing and mailing of prospectuses to other than current shareholders, and the printing and mailing of sales literature." Unlike Rule12b-1, proposed Rule12b-2 would not require mutual fund directors to adopt or renew a written plan or make any special findings. Mutual fund directors would also be excused from reviewing expenses on a quarterly basis, as is currently required under Rule 12b-1.

The Rule 12b-1 proposal would require mutual funds to provide revised or additional prospectus disclosures concerning their use of marketing and service fees and ongoing sales charges. The proposal would also require broker-dealers to provide enhanced disclosures on transaction confirmations concerning the imposition of marketing and service fees, ongoing sales charges, and other charges. This reverses prior SEC guidance, which permits broker-dealers to exclude from confirmations information about mutual fund sales charges if the investor received a prospectus containing that

information. Under the proposal, broker-dealers would be required to provide the following categories of information in their confirmation statements:

- The amount of any-front and sales charge in percentage in dollar terms, together with the net dollar amount invested and any applicable breakpoints;

- The maximum amount of any deferred sales charge, as a percentage of net asset value at time of purchase or redemption;

- The annual amount of any marketing and service fees or ongoing sales charges and the aggregate amount of ongoing sales charges that may be incurred over time, both expressed as a percentage of net asset value, and the maximum number of months or years that the investors will pay ongoing sales charges;

- A statement to the effect that the investor will indirectly pay other-asset based fees charged by the mutual fund, such as management fees in addition to any marketing and service fees or ongoing sales charges; and,

- For redemptions, the amount of any deferred sales charge incurred or to be incurred, expressed in dollars and as a percentage of net asset value.

II. Summary of ACLI Position

- We support the concept of enhanced disclosure and using more descriptive names for services and marketing. We have concerns about a number of technical aspects in the proposal.

- Several significant SEC or other regulatory initiatives would govern variable product and mutual fund fees, services, conflicts and concomitant disclosure. The SEC should stay action on the Rule 12b-1 initiative until it addresses avoidable conflicts and redundancies to minimize confusing coextensive disclosures.

- As the SEC evaluates the Rule 12b-1 proposal, it is important to differentiate publicly available mutual funds from variable contract separate accounts that have different functions and operations supporting long-term obligations. Similarly, variable products must satisfy state regulatory constraints, and are legally enforceable contracts that may not allow modification of fee and service provisions.

- If the SEC advances the Rule 12b-1 initiative, variable contract separate accounts should have appropriate access to future service and fee arrangements on a basis equivalent to mutual funds to facilitate the marketing and servicing of those funds offered through variable products.

- The economic and competitive impact of the Rule 12b-1 proposal needs diligent calculation so that the regulatory objectives of the initiative can be reasonably balanced against its burdens, as required by the federal securities laws. Additionally, repeated systems redesign due to overlapping similar rule developments need to be factored into the cost-benefit analysis.

- ACLI does not oppose the concept of the alternative distribution model in the proposal, but has concerns that the model, as proposed, may disadvantage smaller funds and distributors.

- Grandfathering of Rule 12b-1 charges in underlying funds in existing variable contracts should have an indefinite period rather than a 5-year period.

- The proposals will have a significant impact on variable contract separate accounts used in ERISA retirement plans, which have unique contractual and regulatory considerations that must be factored into the SEC's calculus on the proposal.

III. Background

A. The Operation of Two-tier Variable Contract Separate Accounts

Life insurers manufacture variable annuities and variable life insurance for distribution to individuals, and groups such as pension or 401(K) plans.[2] Variable contracts generally operate under a two-tier structure with the separate account organized as a unit investment trust under the Investment Company Act of 1940. At the top tier, the separate account funds the variable contract based on an underlying menu of mutual funds at the bottom tier. Purchases, sales, and exchanges are transmitted from customers to the life insurance company, which in turn communicates the appropriate instructions to the underlying mutual funds.

The life company processes customer orders directly and through intermediaries. Variable contract customers, therefore, do not have direct contact with the underlying mutual funds. In pension plans, participants transmit allocation instructions through a plan administrator to the life insurer, which conveys the information to the mutual funds underlying the plan's variable annuity contract.

Like mutual funds, life insurers' separate accounts funding variable contracts are registered under the Securities Act of 1933 and the Investment Company Act of 1940 because the account values fluctuate according to the investment experience of an underlying securities portfolio. The structure, operation, and distribution of variable life insurance and variable annuities are, however, different from publicly available mutual funds.

It is important that solutions to the SEC's concerns with distribution fees work fairly with both variable contract owners and mutual fund investors, in spite of structural differences between the two financial products. It will be important to create a properly fitting solution between different financial products. Variable contract separate accounts organized as UITs, therefore, have similarities with, and differences from, publicly available mutual

[2] These variable contracts are hybrid products with important insurance and securities characteristics. The SEC regulates the issuance and sale of individual variable contracts under the federal securities laws. The Department of Labor regulates variable contracts funding employee benefit plans. State insurance departments also regulate the insurance features of variable contracts.

funds. Actions addressing mutual fund distribution fee arrangements should be carefully evaluated with those differences in mind. Solutions must efficiently consider both direct mutual investors and indirect investors through two-tier vehicles such as variable contracts which face different cost and customer service structures.

Some aspects of the proposal, however, do not work smoothly across all product platforms. For example, the tracking mechanics under the proposal may be formidable, if not impossible for variable contract separate accounts organized as UITs. While the application of distribution fees in direct mutual fund investments may operate relatively seamlessly, the same is not true in most two-tier structures funding variable contracts.

Unlike mutual funds, variable annuities are strictly enforceable contracts between insurers and contract owners that are subject to state insurance regulation. Some alternatives to the current distribution fees may be contractually infeasible under existing variable annuity contracts. Moreover, any amendments to variable contracts for revised fee arrangements would need approval of state insurance departments in which the contract was approved for distribution.

B. The Use of Distribution and Service Fees in Variable Insurance Contracts

There is a recurrent premise in the release and in the proposal's design that 12b-1 fees are little more than a disguised form of sales commission or load. We do not agree with that assertion as it relates to variable contracts. Life insurers currently utilize revenue provided by 12b-1 fees from mutual funds underlying variable contract separate accounts to provide a wide variety of services and functions on an ongoing basis that benefit contract owners, and are not simply a thinly veiled form of sales commission. These services and functions include:

- Delivering annually updated underlying fund prospectuses to variable contract owners;

- Redeeming underlying fund shares to pay benefits under the variable contract, such as death benefits, or lifetime annuity payments;

- Training and educating agents about the underlying mutual funds, including introduction of new options as well as changes in existing options;

- Delivering underlying fund prospectus supplements to contract owners;

- Maintaining broker-dealer branch offices and call centers that offer information about underlying funds to contract owners, and facilitate asset allocation and rebalancing advice for contract owners over the life of the long-term contract;

- Purchasing and redeeming underlying fund shares in fulfillment of transactions elected by contract owners, such as cash withdrawals, transfers between underlying funds, or new patterns of premium payments;

- Maintaining informational web sites about underlying fund options; and,

- Tabulating and processing instructions from contract owners about voting fund shares attributable to their variable contracts.

While Rule 12b-1 permits the fees to be used for distribution, including sales commissions, the menu of variable contract functions listed above highlights valuable services for contract owners that supplant the need for underlying funds to perform or charge for these services, particularly in the context of long-term accumulation products like variable life insurance and variable annuities. As explained further below, additional flexibility in the proposal's mechanics and implementation is warranted in light of the manner in which 12b-1 fees are currently utilized in connection with variable contracts.

C. State Regulation of Variable Insurance Contracts

Variable contracts are subject to comprehensive regulation under state insurance laws enforced by state insurance departments in every jurisdiction. Similarly, variable life insurance and variable annuities are enforceable, legal contracts between the life insurer and contract owners. Variable contract features and conditions, including permitted levels of fees and charges, are stipulated in a legal, written agreement, and enforceable between parties. Full implementation of some of the features in the proposal could conflict with the terms of variable annuities and variable life insurance contracts. Further, any post-issuance contract modifications typically require approval of the state insurance regulators. Some aspects may not be eligible for revision, as a matter of contract law. As the SEC evaluates the proposed rule change and new rules, therefore, it will be important to carefully consider the implications for contractual or regulatory conflicts that uniquely affect variable contracts, as compared to publicly available mutual funds.

IV. Coextensive Regulatory Actions Merit Careful Consideration

Perhaps at no other time, have there been more simultaneous and complicated regulatory or legislative initiatives that would govern mutual fund fees, services, conflicts and concomitant disclosure. While we visualize the SEC's objectives in restructuring permitted mutual fund distribution and service fees, it is important as a matter of timing and substance to recognize the multiple related initiatives currently under consideration.

Until these substantively similar initiatives have crystallized, it is premature to advance the Rule12b-1 initiative because all of the multiple proposals could impose a significant and expensive impact on systems, disclosure, and distribution arrangements. Multiple, sequential changes to these factors would invoke expensive operations overhauls. It would be constructive for the SEC to coordinate with the other regulators with coextensive initiatives to eliminate burdensome conflicts or redundant, but different, practices.

It is sensible, therefore, to postpone action on the Rule12b-1 proposal until the multiple interrelated actions have evolved. A brief summary of selected proposals highlights the complexity and interconnectedness of some of the initiatives, and their impact on repeated system rebuilds, disclosure, and distribution or service arrangements.

A. SEC Standard of Care Study

Section 913 of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act directed the SEC to conduct a Study Regarding Obligations of Brokers, Dealers, and Investment Advisers. The SEC Study[3] will evaluate the effectiveness of existing standards of care for brokers, dealers, investment advisers, and associated parties under state, federal or SRO laws for providing personalized investment advice and recommendations about securities to retail customers. Among other things, the study will evaluate whether it would better protect investors if broker-dealers and investment advisers fulfill a harmonized standard reflecting fiduciary duty and suitability concepts. ACLI provided detailed input[4] on the SEC's proposal,[5] which could have a significant impact on broker-dealers and investment advisers distributing variable contracts. The Study follows years of administrative rulemaking on this issue and litigation about it.[6]

Given the significance of the SEC's Study and the potential changes that could reasonably occur regarding fees, disclosure and fiduciary duty which overlap the Rule 12b-1 proposal, it would be prudent to postpone action on the initiative until the outcome of the SEC Study is crystallized. Importantly, there are a number of other recently adopted or proposed substantive regulatory initiatives that could also overlap the SEC's Study, as well as the Rule 12b-1 proposal. Some of these detailed regulatory actions are briefly summarized below to highlight this complex reticulum of interrelated actions.

B. FINRA Initiatives

The Financial Industry Regulatory Authority (FINRA) issued a concept proposal [7] in October 2010 that would require broker-dealers to disclose any conflicts of interests associated with their products and services before doing business with retail investors. FINRA's action occurs while the SEC continues to study the obligations that broker-dealers and investment advisers owe their customers. Under FINRA's proposal, broker-dealers would inform retail customers, at or prior to commencing a business relationship, about the accounts and services that they offer and whether there are any conflicts associated with those services.

Conflicts could include, for example, a situation in which a broker-dealer or its affiliate offers a product that it also sponsored or originated; or where a broker-dealer recommends a product that it also distributes for a fee from the sponsor or originator. FINRA indicated that clarifying disclosure would enable customers to evaluate whether

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[3] *See* Release No. 34-62577; IA-3058; File No. 4-606 (July 27, 2010).

[4] *See* ACLI letter of Comment dated Aug. 30, 2010, in the SEC comment file at http://sec.gov/comments/4-606/4606-2669.pdf or on ACLI's website at http://www.acli.com/ACLI/Issues/Members/Dodd-Frank+Implementation/CT10-119.htm?Issue=55 [ACLI offered recommendations about essential considerations in the SEC's Study, and outlined the industry's position on the harmonization of broker, dealer, and investment adviser regulatory structures. ACLI's submission explains insurance product distribution and the extensive regulatory network governing insurance product sales.]

[5] *See* Release No. 34-62577; IA-3058; File No. 4-606 (July 27, 2010).

[6] *See*, Wilkerson*; The Status of Broker-Dealers Engaged in Investment Advisory Functions: Muddy Waters Slowly Clearing,* ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (2007).

[7] http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122361.pdf .

firms have financial or other incentives to recommend certain products or services instead of other, similar ones.

In addition to its concept release, FINRA has recently proposed significant changes to its suitability rule for general securities sales.[8] Changes to FINRA's suitability rule could also necessitate systems changes for broker-dealers and affiliated entities in fulfillment of enterprise-wide compliance uniformity. This pending action will provoke systems and compliance program overhauls, and will directly impact variable life insurance contracts funded by UIT separate accounts.

C. Department of Labor Actions

1. The Department of Labor ("DOL") recently published a proposal to greatly expand the definition of "fiduciary"[9] under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), for those who provide investment advice for a fee. The proposed regulations would:

- Broaden the range of entities subject to ERISA's strict fiduciary framework. The DOL believes this change would discourage consultants from being influenced by "inappropriate fee arrangements."

- Expand the definition of "investment advice" to include appraisal services. This change is meant to primarily address abuses in the area of employee stock ownership plans by aligning the interests of an appraiser with those of the plan.

The DOL explains that the proposed changes would better address conflicts of interest and fee arrangements resulting from changes in the investment climate since ERISA was enacted, including the growth of 401(k) plans and the complex investment opportunities available to defined benefit plans.[10] This action could directly impact providers of VA and VLI separate accounts used to fund ERISA covered plans. The DOL proposal could intersect or overlap with the SEC's Study as well as FINRA's several fiduciary duty initiatives.

These various administrative actions provide sufficient reasons for a postponement of the Rule 12b-1 initiative until the aggregate impact on systems changes, fees and disclosure can be reasonably ascertained. Without coordination and postponement, there may be overlapping or conflicting standards, and inefficient use of resources in designing systems, disclosure and procedures.

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[8] *See* FINRA Regulatory Notice 09-25 (May 2009), and Rule 19b-1 filing with the SEC for approval of the rule change SR-2010-039.

[9] Under ERISA, a "fiduciary" includes an adviser who renders investment advice for a fee or other compensation, or has the authority or responsibility to do so. Longstanding DOL regulations provide that for an adviser who does not have any discretionary authority within a plan to be considered an ERISA fiduciary, the advice provided must serve as a primary basis for investment decisions and be provided on a regular basis.

[10] These elements may be difficult to establish in many common fact patterns and do not cover a variety of circumstances that the DOL believes may include fiduciary functions such as where consultants advise on investment-related matters, including a plan's investment in complex investment products.

2. On October 20, 2010, the DOL published final regulations[11] regarding plan fee disclosures to participants, which requires the disclosure of certain plan and investment-related information, including fee and expense information, to participants and beneficiaries in participant-directed individual account plans, such as 401(k) plans. This regulation is intended to ensure that all participants and beneficiaries in participant-directed individual account plans have the information they need to make informed decisions about the management of their individual accounts and the investment of their retirement savings. The new rule will be effective for plan years beginning on or after November 1, 2011.

Among other things, the rule requires, if applicable, an explanation that, in addition to the fees and expenses disclosed pursuant to other provisions of the rule, some of the plan's administrative expenses for the preceding quarter were "paid from the total annual operating expenses of one or more of the plan's designated investment alternatives (e.g., through revenue sharing arrangements, Rule 12b–1 fees, sub-transfer agent fees)."[12] This new requirement is intended to provide those participants in plans with revenue sharing arrangements that serve to reduce plan administrative costs with a better picture about how those costs are underwritten, at least in part, by fees and expenses associated with investment alternatives offered under their plans.[13]

3. On July 16, 2010, the DOL published "interim" final regulations[14] imposing new disclosure and related requirements under ERISA for certain service providers to retirement plans. Under ERISA, any person providing services to a retirement plan or its participants is a "party in interest" to the plan by reason of providing those services. ERISA Section 406(a), in turn, generally prohibits a party in interest from providing services to the plan, while Section 408 (b)(2) permits a party in interest to provide necessary services to the retirement plan, under a series of strong conditions.

The new DOL Rule 408(b)(2) imposes detailed compensation disclosure obligations on certain enumerated types of service providers, termed "covered service providers," that reasonably expect to receive $1000 or more in compensation from providing services to a covered plan. Rule 408(b)(2) provides for three broad categories of covered service providers, including ERISA fiduciaries and registered investment advisers, certain record keepers and brokers that make available investment options in connection with such recordkeeping and brokerage services to individual account plans, and service providers receiving indirect compensation.

Significantly, Rule 408(b)(2) requires detailed disclosure of indirect compensation, which is broadly defined and includes, among other things, compensation that is charged directly against the plan's investment and reflected in the net value of the investments, such as 12b-1 fees.[15] Service providers that make investment options available must

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[11] 75 Fed. Reg.202 (October 20, 2010) 64910, http://edocket.access.gpo.gov/2010/pdf/2010-25725.pdf

[12] *Id.*

[13] *Id.* at 64913.

[14] 75 Fed Reg. 135 (July 21, 2010) at 41600.

[15] Under the new rules,

also disclose compensation information about the investments for which it provides services, including: all sales loads, redemption fees and other compensation that will be charged directly against the plan's investments in connection with the acquisition or withdrawal of interest from the investment vehicle, the annual operating expenses of the investment vehicle, and any other ongoing expenses associated with the investment vehicle.

Rule 408(b)(2) disclosure must be provided before a new investment option is added to a plan, and regarding existing arrangements, disclosure must be provided by the July 16, 2011, effective date of the rule.

To satisfy these standards, a number of detailed compliance chores must be completed. Retirement plans and service providers must survey and identify arrangements that may be subject to Rule 408(b)(2) and develop compliant disclosure. Service providers must develop systems to identify and capture all the compensation required to be disclosed. Many service providers will also need to build an internal training program around these requirements and procedures necessary for compliance. Plan fiduciaries and sponsors will need to develop procedures for evaluating the information circulated by service providers. Collectively, these developments are formidable.

Rule 408(b)(2) constitutes another significant regulatory action directly related to the subject of the SEC's Rule 12b-1 proposal. The cumulative impact of this rule together with the other related initiatives outlined above justifies postponement of the SEC's proposal on distribution and service fees so that affected entities do not suffer repeated restructurings of systems, disclosure, and fee or service arrangements. With so many moving and interrelated regulatory parts, it makes sense to allow the different new rules and proposals to further crystallize before the SEC takes final action on the Rule 12b-1 proposal. It would be worthwhile for the SEC to coordinate with the DOL to make sure the two new regulatory initiatives do not conflict or duplicate, before the Rule 12b-1 initiative moves forward. Variable contract separate accounts serve as funding vehicles for ERISA covered plans, and individual retirement accounts and would also face the proposal's impact.

D. SEC Point-of-Sale and Confirmation Proposal.

Another related, pending initiative includes the SEC's proposed point-of-sale and confirmation initiative[16] that would require broker-dealers to provide customers with

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> "the covered service provider must separately disclose such compensation if it is set on a transaction basis (e.g., commissions, soft dollars, finder's fees or other similar incentive compensation based on business placed or retained) or is charged directly against the covered plan's investment and reflected in the net value of the investment (e.g., **Rule 12b–1 fees**). The final rule also requires the covered service provider to identify the services for which such compensation will be paid, the payers and recipients of such compensation, and the status of each payer or recipient as an affiliate or a subcontractor." [emphasis added] *Id.* at 41609.

[16] *See* Release No. 33-8544 ; 70 Fed. Reg. 42 (March 4, 2005). On January 29, 2004, the SEC initially proposed two new rules and rule amendments under the Securities Exchange Act of 1934 designed to enhance the information broker-dealers provide customers purchasing variable contracts, mutual funds, and college savings plans. The initiative elicited over 5,000 letters of

targeted information about costs and conflicts of interest in the sale of mutual funds, college savings plans, and variable insurance products. The release specifically invited comment on the appropriateness of written point-of-sale disclosure for variable annuities and variable life insurance.

The ACLI submitted comments[17] on the proposal, noting that variable life insurance and variable annuity prospectuses promote informed purchase decisions and critical comparison shopping, including comparison of cost features. The SEC upgraded prospectus requirements for variable life insurance and variable annuities that provide plain-English disclosure and cost information in a clear fee table.[18]

According to the most recently published Unified Agenda and Regulatory Plan, the point-of sale proposal is still pending.[19] The Rule 12b-1 proposal should not advance while the SEC point-of-sale initiative is still pending. Coordination and clarification is incumbent on the administrative process.

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comment. On March 24, 2005, the SEC reopened the comment period and invited supplemental input on a new "point-of-sale" document. The proposal would require "targeted information" at the point-of-sale about fees, charges, and broker-dealer conflicts of interest. The initiative also proposed amendments to the post-sale confirmation statements required under the federal securities laws.

[17] *See* http://sec.gov/rules/proposed/s71004/cbwilkerson040405.pdf .

[18] Insurance and annuity purchasers have access to multiple sources of detailed information. In addition to the point-of-sale document, consumers also receive a prospectus, a variable contract, buyers' guides, NASD-approved sales literature, and replacement disclosure forms when a replacement is involved. Variable contracts are the only financial products in today's securities marketplace with free-look provisions. These features give consumers a meaningful opportunity to carefully evaluate purchases after the sale, and to change their mind for any reason, including cost factors.

2002 amendments to the variable annuity fee table in Form N-4 require information about all recurring fees and charges. The revisions also require a narrative that explains the purpose of the fee table and relevant cross-references to the prospectus. The changes require specific explanatory narratives preceding each section of the fee table "to help investors better understand the information about fees and charges in that section."

The SEC staff identifies the fee table as the "current lynchpin of cost disclosure." The fee table is a core feature of the SEC's prospectus simplification project that sought to replace "unintelligible, tedious, and legalistic" disclosure with meaningful information on which to make an informed purchase decision. *See* Arthur Levitt*, Plain English in Prospectuses*, New York State Bar Journal (Nov. 1997) at 36. Parallel fee, charge and expense provisions appear in Form N-6, which sets forth registration and prospectus requirements for variable life insurance separate accounts organized as unit investment trusts. VLI prospectus materials effectively and efficiently convey comparative expense, fee and cost information in a uniform and accurate fashion.

Prospectus illustrations, personalized illustrations, and underlying fund performance are three linked features that give consumers additional tools to evaluate a variable life contract and to make an "apples-to-apples" comparison among different variable life contracts, including the impact of charges on the contract and distribution fees.

[19] See the SEC's Spring 2010 Unified Agenda and Regulatory Plan for short term and long term rulemaking at http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201004&RIN=3235-AJ12 .

E. FINRA Variable Annuity Suitability and Supervision Rule

In 2008, the SEC approved new FINRA Rule 2330[20] governing suitability and supervision in the sale of variable contracts. Among other things, the rule requires broker-dealers to deliver meaningful succinct disclosure at the point-of-sale so that consumers can make informed purchase decisions about the individual variable annuity, notwithstanding the extensive disclosure in the VA prospectus, which may be delivered after the purchase decision, and is generally subject to free-look provisions under state insurance laws. Broker-dealers, or the issuers for whom they distribute, must generate this new point-of-sale disclosure. In an effort to promote meaningful summary disclosure on a uniform basis, the ACLI developed voluntary VA disclosure templates.[21] The ACLI's VA disclosure templates summarize the impact of fees and charges, including the impact of 12b-1 fees if any.[22] We have shared this work with FINRA and the SEC. Further, many state insurance departments have supported and encouraged a parallel companion series of ACLI disclosure templates for fixed and index annuities. This new rule and the industry's disclosure solutions present another new regulatory development that overlaps aspects of the SEC's Rule 12b-1 initiative that are import to holistically acknowledge.

V. Economic Impact of Rule 12b-1 Proposal

The proposal does not provide discussion about the economic and competitive burdens of the Rule 12b-1 initiative. In any administrative rulemaking, it is vital to balance regulatory objectives against the burdens of new requirements. It is difficult to conduct a reasonable balancing without an analysis or estimate of the costs and burdens of complying with the proposal. On several levels, our members believe that the initiative would impose substantial burdens that must be quantified in reasonable rulemaking. The substantial revision of systems, disclosure, and servicing and distribution arrangements will require insurers to consume significant economic and logistical resources.

For example, one of our members has indicated that the economic impact of the proposals as currently drafted would be greater than $30 million, and estimated in particular that the cost of designing and building a system to track each investment in an underlying mutual fund by a contract holder, as it appears would be contemplated by the ongoing sales charge proposal, would be greater than $20 million. Our members have generally indicated that they share similar economic burdens.[23] In short, the proposals are significant, and must be carefully evaluated in terms of economic impact and judiciously balanced against the SEC's regulatory objectives.

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[20] FINRA Rule 2330 is explained in detail in Wilkerson, *FINRA Rule 2821: Suitability and Supervision in the Sale of Variable Annuities,* ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (2008).

[21] ACLI's Annuity Disclosure Templates are explained in greater detail in Wilkerson, *ACLI Disclosure Initiative for Fixed, Index, and Variable Annuities: Constructive Change on the Horizon;* ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (2007).

[22] ACLI's Variable Annuity Disclosure Template is attached as Appendix A, with fee and charge disclosure, including 12b-1 fees, highlighted.

[23] These types of costs are not scalable to size. Systems redesign expenses are not significantly reduced or enlarged based on size or volume.

As required by statute, the SEC must weigh the anticipated benefits of a rulemaking against any resulting costs and burdens for investment companies generally and small funds in particular.[24] In several recent instances, the United States Court of Appeals for the District of Columbia Circuit has emphasized the need for evaluating the costs of complying with new SEC regulations.[25]

Similarly, former SEC Chairman Levitt emphasized the importance of reviewing the economic and competitive impact of rulemaking when he stated:

> In response to the National Securities Markets Improvement Act of 1996 (NSMIA), the Commission has rededicated itself to considering how rules affect competition, efficiency, and capital formation as part of its public interest determination. Accordingly, the Commission intends to focus increased attention on these issues when it considers rulemaking initiatives. In addition, the Commission measures the benefits of proposed rules against possible anti-competitive effects, as required by the Exchange Act.[26]

[24] Section 2(b) of the Securities Act and Section 3(f) of the Exchange Act require the SEC, when engaging in rulemaking where the SEC is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Section 3(f) of the Securities Exchange Act and Section 2(c) of the Investment Company Act require the SEC to consider the impact that a proposal would have on competition, and proscribes the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Acts. *See also* Section 23(a)(2) of the Securities Exchange Act.

[25] *See Chamber of Commerce v. Securities and Exchange Commission*, 412 F. 3d, 133 (June 11, 2005); *American Equity Investment Life Insurance Company v. Securities and Exchange Commission*, Case No. 09-1021 (July 21, 2009) 2009 WL 2152351 [finding that the SEC's examination of the effects on efficiency, competition and capital formation in Rule 151A related to indexed annuities was arbitrary and capricious, and remanding the matter to the Commission for reconsideration]. *See also*, Cohen, I*ndexed and Other Fixed Insurance Products: SEC, FINRA and Sate Regulation after American Equity Opinion and Dodd-Frank Act*, ALI-ABA Conference on Life Insurance Company Products (October 28-29, 2010).

[26] *See* testimony of Arthur Levitt, former SEC Chairman, concerning appropriations for fiscal year 1998 before the Subcommittee on Commerce, Justice, and State, the Judiciary, and Related Agencies of the House Committee on Appropriations (Mar 14, 1997), which appears at http://www.sec.gov/news/testimony/testarchive/1997/tsty0497.txt . Former SEC Chairman Levitt also observed that SEC disclosure simplification began "with the clear understanding that our eventual goal is to purge the entire document of words that, in the famous phrase of George Orwell, 'fall upon the facts like soft snow, blurring the outlines and covering up all the details.' The prospect of multiple different disclosures about the same information in confirmations, point-of-sale, prospectus, and ERISA documentation could collectively dull interest in this information through inundation.

VI. Detailed Comments on the Proposal

A. Grandfathering of Rule 12b-1 Fees

Grandfathering of Rule 12b-1 charges in underlying funds in existing variable contracts should have an indefinite period rather than a 5-year period. It is unclear from the release why a limited grandfathering period is necessary. In the operation of existing variable contracts, contract owners will redeem underlying fund shares over time, and underlying funds will be replaced with newer funds that will have the Rule 12b-2 limits in place. In effect, this will be a self-correcting solution.

There also may be unintended consequences with the limited grandfathering period in the proposal. Existing variable contracts were priced based on the charges permissible at the time of the contract's inception and related actuarial calculations based on those levels of fees and services. If variable contracts must convert different share classes to fulfill the rule's new ongoing fee structure, life insurers will face untenable economic losses and burdens in providing the same level of services to contract owners under a lower fee structure, or will have to reduce the level of services available to contract owners. Neither consequence is an equitable result, especially since it is unclear why the grandfather period has a limited time period. As explained above, 12b-1 fees are used for more than just sales commissions, and support worthwhile contract owner services, such as ongoing advice, asset allocation guidance, and rebalancing information.

Existing contract owners bought the contracts with foreknowledge of the fees and charges, as well as the services they supported in the contract. Variable contract prospectus disclosure clearly outlines these fees, charges and the related services they provide. Thus, a limited grandfathering period does not recognize the context of the contracts' issuance and purchase by consumers. It would be an unwarranted administrative burden to require life insurers to track old shares and new shares. The proposal lacks an estimate of the economic impact of the limited grandfathering period.

The release does not identify the benefits of a limited grandfathering period. This is important in achieving a balancing of the benefits and burdens of the systems conversion after the conclusion of the 5-year period. As discussed above, it is essential to have an accurate estimate of the economic burdens so that the regulatory objectives of the initiative can be reasonably balanced, as required by the federal securities laws.

B. Mutual Funds Underlying Variable Contracts Used by ERISA Plans ("R" Shares)

The Rule 12b-1 release specifically asks[27] whether a class of shares specifically created for retirement plan purposes, often called "R shares":

- Subsidize significant plan expense or obscure the plan costs by bundling them with mutual fund costs,
- Obscure fees to plan participants, and finally

[27] *See* text accompanying footnotes 386-397 in Release Nos. 33-9128; 34-62544; IC-29367; File No. S7-15-10 (July 21, 2010) available at http://sec.gov/rules/proposed/2010/33-9128.pdf .

- Whether current 12b-1 fees could be construed as paying for something other than services that are not for the exclusive benefit of fund investors.

Providers of administrative services to retirement plans charge for those services. Those services include plan and account record keeping, administration, plan compliance monitoring, and participant education. They also include operational requirements such as accounting, trading and cash movement or reconciliation. Responsible plan fiduciaries under ERISA evaluate and approve fees charged for these functions. Part of the fiduciary's responsibility is to ensure that such fees are reasonable. It is also the plan fiduciary's decision to determine how such fees are paid. ERISA allows for reasonable fees to be paid from plan assets.

The fiduciary decides how the fees will be paid. Routinely, the fiduciary deliberately selects certain share classes that maximize the amount of administrative revenue support toward the plan fees, so as to minimize the bill that might be paid by the plan sponsor. It is important to note that lowering of amounts of support toward plan fees through lower 12b-2 amounts will not change the fiduciary's decision on how much support toward plan fees will come from the plan assets. Such plan fees will be deducted from plan assets per the direction of the plan fiduciary resulting in the same net fee amounts coming ultimately from participant accounts. In fact, plan participants may be worse off because these additional netted fee amounts from participant accounts may be more difficult to track than tracking daily NAV of publicly available mutual funds at NAV.

As a result of the proposed Rule 12b-2 changes, it would be likely that the cost of administrative services to retirement plans may increase. The cost of overhauling structures and systems will certainly be amortized and passed on to the plans. The plans' fiduciaries could, in turn, pass those additional plan fees on to participants by having them deducted from the plan assets, resulting in participant accounts being put into a less advantageous position. Additionally, to the extent that plans must now track multiple share classes due to automatic conversions if there are ongoing sales charges used, this could add cost to record keeping, as well as eliminating economies of scale by creating a modified retail environment, rather than the efficiency of a plan level institution. These costs could also be passed on, as decided by fiduciaries, to the detriment of participant account balances. The plan fiduciaries most affected by these increases in administrative services and fees are those that sponsor small retirement plans.

Finally, it is noteworthy that plan fiduciaries are responsible for understanding plan fees in order to make decisions. In fact the Department of Labor recently released an interim final regulation on fee disclosure under ERISA section 408(b)(2), where a significant onus of fee disclosure is placed on service providers to ensure that the responsible fiduciary is properly equipped to make these decisions. We'd argue that there was never any widespread obscuring of costs to plans, but to the extent there were pockets of concern, those are certainly addressed by the ERISA 408(b)(2) regulation.

It is generally believed that the average participant in a retirement plan does not fully understand the plan, its terms, its operation, the services required to maintain its operation, or its fees. Whatever the underlying reason, it is clear that ERISA anticipates that the average participant is not properly equipped to make certain decisions on their own, and that is why plan decisions are required to be made by responsible fiduciaries on behalf of all participants and beneficiaries under the plan.

However, the Department of Labor also recognizes that plan participants are charged with making certain decisions on their own, particularly asset allocation in a participant directed defined contribution plan. There are already regulations under ERISA Section 404(c) that require certain information to be given to plan participants making their own asset allocation decisions. Among the required information is the provision of a prospectus for mutual funds.

As a result of these informational sources, participants are already receiving information about the fees in their funds and there is nothing "obscured" today. However, the DOL released on October 14, 2010, participant fee disclosure regulation. This regulation will supplement the 408(b)(2) regulation discussed above, and to the extent there are gaps in participant knowledge on fees, the participant fee disclosure regulation will cover it.

In summary, we do not feel the fees in mutual funds offered to fiduciary controlled entities like ERISA retirement plans have been obscured. To the extent there is a concern regarding adequate disclosure of these fees, the interim final regulations on ERISA Section 408(b)(2) issued by the Department of Labor are addressing this, and additional action from the SEC should be not be necessary, or should at least be delayed until those regulations are given a chance to work.

C. 12b-1 Fees Paying for Services not for the Exclusive Benefit of Fund Investors

ERISA allows the deduction of fees from plans assets only to the extent that they are reasonable and necessary for the ongoing operation and health of the plan. Currently 12b-1 fees are applied toward these reasonable and necessary expenses in the context of ERISA qualified plans.[28] The ongoing operation and health of the plan benefits all plan participants.

Increasingly, the retirement market is seeing more advisers move to a more robust service model and a higher level of liability in terms of the services the advisor is providing to the client. These services are arguably focused as much on ongoing client relationships as they are on developing new relationships and include participant education, relationship management with the benefit staff and key decision makers, and investment analysis, selection and monitoring. Plan fiduciaries value these services and rely on 12b-1 fees to support the compensation for these services. Advisers also commonly perform due diligence reviews, which have a different fiduciary standard than in the retail space. In fact, regulations are expected from the DOL on the fiduciary definition[29] for this type of adviser with ERISA plans, and the appropriate levels of compensation for these responsibilities. At the very least, 12b-2 should be delayed for ERISA plans until such time as regulations are issued and given a chance to work.

Overall, plan fiduciaries have responsibility for the appropriateness of fees in ERISA arrangements. Fee structures have been developed in the marketplace to address the

[28] It is important to note that settlor fees (those that benefit the plan sponsor and not the plan, such as plan design consulting) are not deductible from plan assets, and 12b-1 fees are not used to cover such settlor fees. These sorts of fees are paid directly by the plan sponsor and not by the plan.

[29] *See* ERISA Sections 3(21) and 3(38)

needs and desires of these fiduciaries. The DOL is already working with its jurisdiction over these plans to ensure there is appropriate disclosure given to fiduciaries so that they can effectively carry out their fiduciary duty. It is inappropriate to regulate structures that will hinder the flexibility that these responsible fiduciaries need in order to carry out their fiduciary duty.

D. Consequences of Rule Proposal on R Shares, Small Funds and New Funds

The proposal limits marketing and service fees to 25 basis points. Any amounts that fall outside this "bucket" would need to be considered a sales charge and would need to be tracked and limited to the maximum sales charge allowed.

For many recordkeepers, much of what they charge would fall into the definition of “marketing and service fee” and is significantly greater than 25 basis points. For example, the proposed limit of 25 basis points could force retirement plans, which typically incur higher administration costs for a large number of small accounts to look for other funding options. Similarly, smaller funds and new funds may incur higher administration or marketing costs in relation to the level of invested assets, as they struggle to achieve economies of scale. We believe that if the final rule were to raise this limit to, for example, 50 basis points or more, that would greatly relieve the burden that the proposed rule would impose on retirement plans, newer and smaller funds that may need to pay more for the associated services they receive.

While the proposed rule would exclude from the marketing and service fee limit administrative service fees, sub-accounting service fees and sub-transfer agency service fees, there are still other types of shareholder service fees that recordkeepers must charge to cover one or more of the following:

- Adviser compensation;
- Participant mailings-routine, and non-routine mailings associate with fund menu changes, fund mapping details;
- Costs associated with implementing regulatory changes, such as Rule 22(c)(2) compliance;
- Integration costs associated with participant investment assistance tools;
- Marketing support costs in regard to custom Plan campaigns designed to attract and educate Plan participants;
- Costs associated with Plan/Product features;
- Receipt and application of payroll deposits;
- Regulatory reporting;
- Accounting reports;
- Production and delivery of customer statements;
- Customer service via phone and 24/7 online access;
- Daily valuation and account transaction services;
- Investor education via online and in-person meetings;
- Plan sponsor assistance;
- Regulatory and compliance assistance, such as ERISA issues;
- In-person actuarial assistance; and,
- In-person investment reviews.

A 50 basis point, or higher, limit rather than the proposed 25 basis point limit would allow many recordkeepers to continue existing business operations and not cause a major disruption to how these plan and participant expenses are satisfied. The SEC should carefully consider this suggestion in light of the valuable services listed above, and the fact that participants in retirement plans, and smaller or newer funds may be harmed through a 25 basis point cap, if services are reduced, or if additional charges are assessed to cover required services.

E. Alternative Distribution Model Issues

The Rule 12b-1 initiative proposes Rule 6c-10(c), which would make it possible for funds and broker-dealers to offer an alternative distribution model to consumers. Proposed Rule 6c-10(c) would exempt broker-dealers from Section 22(d) of the Investment Company Act ("the Act") that requires broker-dealers to follow uniform pricing schedules. The proposal would allow the distributor or financial intermediary to set their own pricing schedule for certain share classes. The administrative goal is to increase competition in the marketplace between broker-dealers and other financial intermediaries. Life insurers support open and fair competition in the markets but we are concerned about the legal and operational implications of the Commission's proposal.

Section 22(d) of the Investment Company Act precludes dealers from establishing separate pricing schedules. The section effectively allows mutual funds to control their distribution, and ensures that consumers can rely on a fund's prospectus as an accurate representation of fees. Section 6(c) of the Act gives the SEC the authority to adopt rules exempting persons or transactions from the Act, so long as the exemption is (i) necessary, or (ii) appropriate in the public interest, and (iii) consistent with the protection of investors and purpose of the Act. Rule 6c-10(c) appears to be inconsistent with Section 22(d), because it would exempt broker-dealers from complying with the explicit distribution rules of Section 22(d). The release explains the discrepancy by noting that the Congressional intent in drafting Section 22(d) is unclear. However, since the rule on its face is clear, it's not apparent why the release identifies the lack of clarity about the legislative intent to create an exception to the law. Because the language in Section 22(d) is unambiguous, the release should provide clarification on the foundation for the proposed exemption.

ACLI does not oppose the concept of the alternative distribution model. We have concerns, however, about the alternative's mechanics as explained in the release. Specifically, we believe that the alternative may have the effect of reducing the number of available funds or distributors marketing funds, if larger mutual fund complexes are able to negotiate lower distribution fees based on their economies of scale. This would be harmful and contrary to the proposal's stated objectives, including to increase competition.

We are also concerned that it may be difficult for life insurers to properly disclose the ranges of the various fees and charges in confirmations statements under the alternative distribution model. If this approach remains in the proposal, we believe that the SEC should clarify its application to no-load variable contracts. No-load variable contracts have marketing and service fees that are used for service providers in generating ongoing services and marketing that may have nothing to do with distributors. It would be constructive for the SEC to acknowledge that marketing and service fees may be

paid to entities other than distributors to obtain these functions in no-load variable contracts.

Companies may need specific, separate prospectuses to deal with the alternative distribution model. The proposal contains a core presumption that 12b-1 and 12b-2 fees are used solely for distribution charges. The use of the fees in variable contracts is broader than merely distribution, and also covers marketing and service functions.

F. Rule 12b-2 Confirmation Disclosure

We believe that requiring the new Rule 12b-2 fees to be included in the confirmation statement for variable contract purchases may result in customer confusion. Currently, confirmation statements include precise calculations of actual transactional charges. Under the proposal, firms would be required to include information regarding ongoing, asset-based fees and charges. The extent to which these asset-based fees and charges are tied to each transaction is not precisely calculable, and would mix precise transactional information with imprecise, estimated ongoing fee and charge information. This confusing mixture of hard and soft information conflicts with the SEC's noteworthy goal of clear unambiguous disclosure.

G. Rule 12b-2 Clarifications

Life insurers' variable products should have the same access as publicly available mutual funds to the fees permitted under new Rule 12b-2, to be able to provide contract owners with the same services available to mutual fund shareholders. Underlying funds are a big part of marketing of variable products to customers and the ability to offer a wide variety of fund choices is critical. In the past, life insurers' variable products principally featured proprietary underlying funds. With the more current variable products, there has been a shift to non-proprietary underlying funds that need to be explained to customers in the marketing and sales process. The availability of nonproprietary products enhances choice for customers, and warrants access to the marketing and service fee.

While the release does not suggest limitations on recipients of marketing and service fees, it would be constructive to clarify further that the fees can be paid to a variety of entities, and are not limited to broker-dealers. Clarification is necessary because the insurance company, or a TPA or other servicing entity may be contractually providing the menu of services listed above on behalf of the principal underwriter or selling broker-dealer. Generic disclosure of the types of entities that may be recipients of these fees is an acceptable alternative to more explicit clarification.

H. Ongoing Sales Charge Issues

Underlying funds to variable contracts currently pay ongoing sales charges to support the same functions and services provided to mutual funds and described in Section III, B of this letter. These ongoing sales charges are also used to compensate distributors for services they will continue to provide to investors in underlying funds of variable contracts throughout the life of the contract owner. Variable contracts are designed to be

long term investments, as such; investments in the underlying funds of variable contracts will be for a longer duration than investments in publicly available mutual funds.
Capping the amount of ongoing sales charges to pay for services to variable contract underlying fund shareholders may force the discontinuance of some services, or a shift in providers, regardless of the preferences of the contract holders.

The proposal's requirement for age tracking of ongoing sales charges also does not work as well with variable contracts and underlying funds because of different mechanics and associated complexities. As an alternative to the proposal in the rule, some companies may be able to monitor and estimate when the individual may hit the maximum sales charge on the contract, and an administrator will move the customer's interests into a new share class that does not incur the sales charge. However, this may not work for every company as it would require monitoring every fund for every customer. Additionally, the age tracking provisions do not address the fact that variable contracts will continue to consume worthwhile services over a longer period relative to mutual fund investments that must be funded.

Variable contracts are long term products that can extend over 30, 40 or 50 years. The requirement to cap underlying fund charges arbitrarily at 5 years does not take the differences between underlying funds in variable contracts and mutual funds into account. The proposal's linkage to the FINRA cap of 6.25 is also problematic as a static number that will not likely be revisited to consider new factors and services that may evolve over time, which could ultimately be detrimental to consumers. Until the age tracking issues are resolved, therefore, it is not logical to cap ongoing charges at arbitrary levels that do not take meaningful product differences and durations into consideration.

VII. Conclusion

We greatly appreciate your attention to our views. If any questions develop, please contact me.

Sincerely,

Carl B. Wilkerson.

Appendix A

VARIABLE ANNUITY DISCLOSURE MATERIALS

How to Complete the Template for a Variable Annuity Disclosure

Example 3A: Template for a Variable Annuity Disclosure

Example 3B: Sample of a Variable Annuity Disclosure

HOW TO COMPLETE THE TEMPLATE FOR A VARIABLE ANNUITY DISCLOSURE

The following is a guide to writing a disclosure for an variable annuity. It includes guidance for writing statements; the types of information that should be covered under each required section, the headings to be used and questions to be answered; and in some cases, provides suggested language that can be used. **Disclosure documents must be prepared consistently with FINRA conduct rule 2210 (Communications to the Public).**

Example 3A on page 29 shows a graphic of a variable annuity disclosure template; Example 3B on pages 30–31 is an example of what an actual product disclosure may look like; Addendum X shows the disclosure document to scale. Companies are encouraged to follow the language used in the sample.

Note: **The variable annuity disclosure document may be presented in two forms: print or electronic. If distributed electronically, in addition to providing direct links to the annuity prospectus or supplement material for more information, companies also should keep references to specific pages (and, if appropriate, headings on that page) in the event consumers prefer to print hard copies.**

Guide to Writing Disclosure Statements

- Make a clear distinction about whether a statement is true of all annuities ("an annuity") or all annuities of this type ("a deferred annuity") or this product ("this annuity," "this deferred annuity").
- In a question, refer to the reader as I (my annuity). In the answer, refer to the reader as you (your annuity). Refer to the company as "we" or use the name of the insurance company. Don't use the generic "insurer" or "company."
- Avoid statements that don't give specific information or don't give the reader information to find specific information. For example, "Interest is credited to your account" is a general statement that isn't very useful. "Interest is credited to your account daily" is a specific statement of information as is "Page 23 of your annuity prospectus explains the different ways that interest may be credited to your account."
- Use specific terms (i.e. surrender) from your annuity prospectus in the disclosure but include a definition in parentheses after.
- Put important terms in bold font the first time you use them. Be selective about what terms you consider important. If too many words are in bold, the technique loses its effectiveness.
- If you refer the reader to the annuity prospectus for more information be specific about what information is there and exactly where to find it (e.g. use page numbers or section titles).
- The phrasing "includes" ("Your options include") suggest there are other options not stated here. If you've stated all of the options, say "Your options are." If you plan to add options later, say, "Your options now are."
- Use "annuity prospectus" when you're referring the consumer to the written prospectus.
- Don't use the word policy to refer to an annuity.
- When possible, present information in a bulleted list with a brief description and refer to a specific page number in the annuity prospectus for more information.

SECTION 1: INTRODUCTION

- Include your company name and name of the product at the top of the page. A company logo also may be inserted.
- Include statements that briefly explain each of the major features of the annuity. (Suggested language: This annuity is deferred, which means payouts begin at a future date.)
- Specify that this is a variable annuity and include a definition. (Suggested language: This is a variable annuity: the return on your investments will vary with changes in the market OR its value depends on the performance of the investments you chose.)
- Include a statement that the buyer can use an annuity for lifetime income but it is not meant for short-term goals. (Suggested language: You can use an annuity to save money for retirement and to receive retirement income for life. It is not meant to be used to meet short-term financial goals.)
- Specify if the annuity is single-premium or flexible premium. (Suggested language: This annuity is single-premium which means you buy it with one payment (premium) **or** flexible premium which means you can purchase it with multiple payments (premiums)).
- Include information about how the annuity accumulates earnings. For example: This annuity can accumulate earnings in two ways: 1) from various investment choices we offer and 2) from a fixed interest account of XYZ Life Insurance Company.

SECTION 2: THE ANNUITY CONTRACT

What are my investment options?

- Explain how the annuity accumulates earnings, clearly distinguishing between guaranteed, non-guaranteed, and determinable elements, including their limitations.
- List how many investment choices are currently available, explain the choices the consumer must make, and refer to the specific pages of the annuity prospectus where detailed information is available. (If the disclosure is online, this section may provide a link to more information about investment choices.)

SECTION 3: BENEFITS

What are the benefits of my annuity?

- List and describe the benefits of the annuity and include links, page numbers, or section headings for more information.

Guide to writing statements in this section:

- Use the term premium to refer to money the consumer pays you. Use the term payout to refer to money you pay the consumer.
- Use the same terms that are used in the annuity prospectus for payout options, but include a clear explanation of each.
- If the annuity prospectus uses another term for payout, the first time it appears put the other term in the disclosure followed by payout in parenthesis. After the first time, use the generic term payout.
- When you use a table, explain the table. An example using information from the table is a good way to explain the table.
- Be specific when you refer to the annuity prospectus; include links, page numbers and, if appropriate, headings on that page.

How do I get income (payouts) from my annuity?

- Mention the various payout options and provide a link to the annuity prospectus, page numbers, or section headings where more information is available.
- Explain what happens if the annuitant doesn't choose a payout option.

SECTION 4: OPTIONAL BENEFIT RIDERS AND THEIR FEES

What other benefits can I choose?

- List **all** optional riders, briefly describe each, and include either the range of fees or the maximum fee charged for each option. Include links, page numbers, or section headings and refer to specific

page numbers or section headings in the annuity prospectus and supplement material for more information.

Guide to writing statements in this section:

- Present information in a chart or table.
- Be specific when you refer to the annuity prospectus; include links, page numbers and, if appropriate, section headings on that page.
- Use the same terms used in the annuity prospectus for riders, but include a brief explanation of what the rider offers.

SECTION 5: RISKS

What are the risks?

In this section, describe the types of risks in a bulleted list with a brief description of each. If online, include a link to the relevant information. Also include specific page numbers in the annuity prospectus for more detailed information. This section should describe:

- Risks to guaranteed elements.
- Risks associated with underlying investments.
- Options and restrictions on withdrawing money from the annuity.
- Tax consequences for early withdrawals.

Guide to writing statements in this section:

- Use the terms used in the annuity prospectus for risks, but include a brief explanation of what each risk is.
- Be specific when you refer to the annuity prospectus; include links, page numbers and, if appropriate, headings on that page.

SECTION 6: FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?

This section should outline:

- The amount of surrender charges and when they are paid.
- If the variable annuity contract is designed without surrender charges, the question should be answered to indicate that no surrender charges apply under the contract provisions for surrenders.
- Any other charges or adjustments in the amount received when taking money from an annuity.

Guide to writing statements in this section:

- If the annuity prospectus uses another term for surrender charge, the first time it appears in the disclosure, put the other term followed by surrender charge in parentheses. After the first time, use the generic term surrender charge. (Example: XYZ Life Insurance Company takes a contingent deferred sales charge (also known as a surrender charge) …).
- State surrender charges in a table format and include an example to explain the table.
- Be specific when you refer to the annuity prospectus; include links, page numbers and, if appropriate, headings on that page.

What fees or charges do you take from my annuity account value?

- List and describe contract fees, such as annual contract fees and annual portfolio expenses. You may list the range of each fee or the maximum fee charged for each.

Do I pay any other fees or charges?

- List and describe any other fees or charges that apply, such as annual service charges, maintenance charges or transfer fees, and disclose amounts. Include links, page numbers, or section headings in the annuity prospectus for more information.

Guide to writing statements in this section:

- A table may be useful to explain fees and charges. If you use a table, include an example to explain the table.

SECTION 7: TAXES

How will payouts and withdrawals from my annuity be taxed?

This section should outline:

- The meaning of tax-deferred (Suggested language: Variable annuities are tax-deferred which means you don't pay taxes on accumulated earnings until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the accumulated earnings. You also defer paying taxes on earnings if you move money from one investment option in your annuity to another. You may pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2.)
- If your company takes premium taxes from withdrawals or payouts, include a statement describing the deduction. (Suggested language: If your state imposes a premium tax, it will be deducted from the money you receive.)
- That one tax-deferred annuity can be exchanged for another without paying taxes on accumulated earnings. (Suggested language: You can exchange one tax-deferred annuity for another without paying taxes on the accumulated earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities.)

Does buying an annuity in a retirement plan provide extra tax benefits?

- Explain that there are no additional tax advantages to buying an annuity in an IRA, 401 (k) plan or other tax deferred retirement product. (Suggested language: Buying an annuity within an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. Choose your annuity based on its other features and benefits as well as its risks and costs, not its tax benefits.)

SECTION 8: OTHER INFORMATION

What else do I need to know?

All disclosures should include the following statements, modified as needed to match your situation.

Changes to your contract

We may change your annuity contract from time to time to follow federal or state laws and regulations. If this happens, we'll tell you about the changes in writing.

Compensation

We pay the salesperson and the firm he or she is associated with for selling this annuity to you. The compensation they receive could create a conflict of interest by influencing them to recommend one product over another. Ask your salesperson for more information.

Free look

Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract [Insert link, page number or section title] or the annuity prospectus [Insert link, page number or section title] to learn about your free look period. (Or replace suggested language with state and company specific information about free look.)

Include in this section other important information that doesn't appear elsewhere.

What should I know about the insurance company?

Include in this section a general description of the company as well as all contact information, including an address, phone number, Web site, and e-mail address (as applicable). You also may consider including financial strength ratings.

All disclosures should include the following statement, modified as needed to match your situation:

- Note: The about information is current as of the annuity prospectus dated___. This is a summary document. The prospectus contains important information required under the federal securities laws. If you wish to receive a paper copy of the prospectus and supplement material, click here or call 800-123-4567. There is no charge for paper copies.

EXAMPLE 3A

Template for a Variable Annuity Disclosure

Example 3A shows how to group disclosure material into sections and in two-column format. Disclosure documents should be kept short. The template also includes the section headings that are to be used, the questions that need to be answered, and provides direction. Refer to the accompanying instructions for more information about how to complete the template and for suggested language. Disclosure documents must be prepared consistently with FINRA conduct rule 2210 (Communications to the Public).

Note: **The variable annuity disclosure document may be presented in two forms: print or electronic. If distributed electronically, in addition to providing links to the prospectus, keep references to specific pages in case consumers choose to print hard copies.**

SECTION 1

[COMPANY NAME]

[PRODUCT NAME] Disclosure

[STATE COMPANY NAME AND NAME OF PRODUCT. SPECIFY IF THE ANNUITY IS A SINGLE- OR FLEXIBLE- PREMIUM. INCLUDE STATEMENTS THAT BRIEFLY EXPLAIN MAJOR FEATURES AND HOW THE ANNUITY ACCUMULATES EARNINGS. DISCLOSE THAT THE ANNUITY IS NOT MEANT TO BE USED TO MEET SHORT-TERM GOALS. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

SECTION 2

THE ANNUITY CONTRACT

What are my investment options?

[EXPLAIN THE CHOICES THE CONTRACT OWNER MUST MAKE, INCLUDING HOW MANY INVESTMENT OPTIONS ARE AVAILABLE AND THEIR VARYING DEGREES OF RISK AND THE CURRENT RATE OF THE FIXED ACCOUNT.]

SECTION 3

BENEFITS

What are the benefits of my annuity?

[LIST AND DESCRIBE THE ANNUITY'S BENEFITS.]

How do I get income (payouts) from my annuity?

[DESCRIBE VARIOUS PAYOUT OPTIONS.]

SECTION 4

OPTIONAL BENEFIT RIDERS

What other benefits can I choose?

[LIST AND DESCRIBE ALL OPTIONAL RIDERS. INCLUDE EITHER THE RANGE OR MAXIMUM FEE CHARGED FOR EACH.]

SECTION 5

RISKS

What are the risks?

[LIST AND DESCRIBE RISKS TO GUARANTEED ELEMENTS, RISKS ASSOCIATED WITH THE UNDERLYING INVESTMENTS, RESTRICTIONS ON WITHDRAWING MONEY, AND TAX LIABILITIES FOR EARLY WITHDRAWALS.]

SECTION 6

FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?

[STATE SURRENDER CHARGES AND PROVIDE AN EXAMPLE.]

What fees or charges do you take from my annuity account value?

[LIST AND DESCRIBE CONTRACT FEES AND PROVIDE AN EXAMPLE.]

Do I pay any other fees or charges?

[LIST AND DESCRIBE ANY OTHER FEES OR CHARGES THAT APPLY AND DISCLOSE AMOUNTS.]

SECTION 7

TAXES

How will payouts and withdrawals from my annuity be taxed?

[DESCRIBE THE MEANING OF TAX-DEFERRED. INCLUDE A STATEMENT DESCRIBING ANY DEDUCTION TAKEN FOR PREMIUM TAXES. EXPLAIN TAX TREATMENT OF EXCHANGES. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

Does buying an annuity in a retirement plan provide extra tax benefits?

[EXPLAIN THAT THERE ARE NO ADDITIONAL TAX BENEFITS. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

SECTION 8

OTHER INFORMATION

What else do I need to know?

Changes to your contract

[INCLUDE A STATEMENT EXPLAINING THAT THE CONTRACT OWNER WILL BE NOTIFIED IN WRITING OF ANY CHANGES TO THE CONTRACT. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

Compensation

[INCLUDE A STATEMENT EXPLAINING THAT THE COMPENSATION RECEIVED BY THE SALES REPRESENTATIVE COULD CREATE AN INCENTIVE FOR RECOMMENDING ONE PRODUCT OVER ANOTHER. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

Free Look

[INCLUDE STATE AND COMPANY SPECIFIC INFORMATION ABOUT FREE LOOK. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

What should I know about the insurance company?

[PROVIDE RELEVANT COMPANY INFORMATION, INCLUDING ADDRESS, PHONE NUMBER, WEBSITE. ALSO INCLUDE THE FOLLOWING STATEMENT, MODIFIED TO MEET SPECIFIC COMPANY SITUATION: *Note: the above information is current as of the annuity prospectus dated____. This is a summary document. The annuity prospectus contains important information required under the federal securities laws. If you wish to receive a paper copy of the prospectus and supplement material, click here or call 800-123-4567. There is no charge for paper copies.*]

EXAMPLE 3B

Sample of a Variable Annuity Disclosure

Example 3B is a sample of how a final disclosure document might look. Addendum X shows document to scale. This is a only a sample and is not intended to serve as a model disclosure for all types of annuities. Disclosure documents for each company and product will vary. Disclosure documents must be prepared consistently with FINRA conduct rule 2210 (Communications to the Public).

Note: **The variable annuity disclosure document may be presented in two forms: print or electronic. If distributed electronically, in addition to providing links to the prospectus, keep references to specific pages in case consumers choose to print hard copies.**

Variable Annuity Disclosure

XYZ LIFE INSURANCE

This document reviews important points to think about before you buy this XYZ Life Insurance Company annuity. This variable annuity is a contract between you and our company. It is a single-premium annuity which means you buy it with one payment (premium).

This annuity is deferred, which means payouts begin at a future date. You can use an annuity to save money for retirement and to receive retirement income for life. It is not meant to be used to meet short-term financial goals. You may pay a fee if you take out money before the end of a time period specified by the contract.

This annuity is variable, which means its value depends on the performance of the investments you chose. This annuity can accumulate earnings in two ways: 1) from various investment choices we offer and 2) from a fixed interest account of XYZ Life Insurance Company.

If you have questions about this annuity, please ask your agent, broker, advisor, or contact a company representative at 800–123–4567.

THE ANNUITY CONTRACT

What are my investment options?
You can invest your money in our fixed interest account and in any or all of the investment choices we offer. Click on the links below or refer to pages of the annuity prospectus for more information about your choices.

- **Investment choices:** You may choose from 41 fund portfolios that have different investment objectives and levels of risk (see page 13).
- **Fixed account**: This choice offers a guaranteed rate of return, which currently is 3% (see page 12).

BENEFITS

What are the benefits of my annuity?
The benefits of your annuity are described below. Click on the links provided or read the section of the annuity prospectus for more information.

- **Death benefits:** This annuity includes a death benefit that will be paid to your beneficiary if you die before your income payouts begin. This benefit equals either your premium minus any withdrawals or the contract value, whichever is greater (see page 28).
- **Nursing care and terminal condition withdrawal:** If you or your spouse are in a hospital or nursing facility for 30 consecutive days or diagnosed with a terminal condidtion after the annuity was issued, you can take money from your annuity without paying a fee (see page 37).
- **Unemployment waiver:** If you (or your spouse) become unemployed, you won't pay fees when you take out money if certain conditions defined in the contract are met (see page 37).
- **Systematic payout option:** You can get monthly, quarterly, or annual payouts from your annuity in set amounts at any time without paying certain fees (see page 34).

What types of income (payouts) can I get from my annuity?
You can choose to get payouts for you and a joint annuitant for life or for a specific period of time or you can choose a lump sum payout. (Pages__ explain your payout options.)

OPTIONAL BENEFIT RIDERS AND FEES

What other benefits can I choose?
The contract also offers other benefits for an extra cost. Your choices and the fees charged are described below. You will pay a fee for each option you choose every year you own the annuity. The fee is calculated as a percentage of the value of your investments. Click on the links or refer to pages in the annuity prospectus and supplement material for more information, including how fees are calculated.

Annual Fees for Optional Benefit Riders

Additional Death Benefit Riders	CURRENT	MAXIMUM
Additional Death Distribution Option Pays your beneficiary an extra death benefit in specific situations (description of benefit: supplement pages 35–36; explanation of fee: supplement page 23).	.20%	20%
Living Benefit Riders	CURRENT	MAXIMUM
Guaranteed Minimum Accumulation Benefit: Guarantees a future value of your annuity no matter how the investment options you choose perform (description of benefit: supplement pages 4–5; explanation of fee; supplement pages 7–8).	.40%	.50%
Guaranteed Minimum Withdrawal Benefit: Guarantees an annual amount you can take out of your annuity regardless of its value (description of benefit: supplement pages 5–7; explanation of fee; supplement pages 7–8).)	.50% (single) .85% (joint)	1.00%

RISKS

This annuity has several risks. Click on the links below or read the annuity prospectus for more information about:

- **Risks of your annuity contract:** There's a risk that we won't be able to pay claims on guaranteed annuity contract benefits, such as the guaranteed minimum accumulation value (see page 12).
- **Risks based on the investment portfolio you choose:** The investments you choose may decrease in value; if any of them do, the value of your annuity will go down. You may lose money if you take money out in whole or in part when the value is down (see pages 15–16).
- **Access to your money:** You may pay a fee (surrender charge) if you take out money before the end of the fifth contact year (see the next section of this disclosure or pages 24–25).
- **Your tax liability:** You may pay a 10% federal income tax penalty on earnings in addition to taxes due on earnings if you withdraw money before age 59 1/2 (see section on "Taxes" or pages 29–34).

CONTRACT FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?
You may pay a surrender charge if you take out money before the end of the fifth contract year. Here's how the charge is calculated.

Contract Year	1	2	3	4	5	6+
Surrender Charge	5%	4%	3%	2%	1%	0

Example: If you withdraw $5,000 from your annuity in the third contract year, your surrender charge is $5,000 x .0.03 = $150. If you take out any amount after the end of the fifth contract year, there's no charge.

You may not have to pay a surrender charge if you take out part of your money (a partial surrender). **Click here** or see pages 20–21 of the annuity prospectus for more information about surrender charges.

What fees or charges do you take from my annuity account value?
You will pay fees every year you own the annuity. The fees are calculated as a percentage of the contract's value.

Annual Contract Fees
(not including fees for optional riders)

	Current	**Maximum**
Mortality and expense risk	.95%	1.35%
Administrative	.10%	.15%
Total annual contract fees	**1.50%**	**2.27%**

Example: Cost Based on Annual Contract Fees

Investment value	**Current (1.50%)**	**Maximum (2.27%)**
$1,000	$15.00	$22.70
$50,000	$750.00	$1,135.00
$100,000	$1,500.00	$2,270.00

Total Annual Portfolio Operating Fees

Minimum	.85%	Maximum	1.42%

Example: Cost Based on Annual Portfolio Operating Fees

Investment value	**Minimum**	**Maximum**
$1,000	$8.50	$14.50
$50,000	$425.00	$710.00
$100,000	$850.00	$1,420.00

Do I pay any other fees or charges?
A service charge of $35 will be deducted from your contract's value each year. This charge is waived if the contract value is more than $50,000 on the contract anniversary or at the time of surrender. You also may be charged a transfer fee. Under your contract, you may make 12 free transfers annually. After that, we will charge you $10 for each additional transfer. You also pay a fee for each optional rider you choose (see section on optional benefit riders and fees). **Click here** or see page 10 of the annuity prospectus for more information about fees and charges.

TAXES

How will payouts and withdrawals from my annuity be taxed?
Variable annuities are tax-deferred, which means you don't pay taxes on the annuity's accumulated earnings until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the accumulated earnings. You also defer paying taxes on earnings if you move money from one investment option in your annuity to another. You may pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2. If your state imposes a premium tax, it will be deducted from the money you receive.

You can exchange one tax-deferred annuity for another without paying taxes on the accumulated earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities.

Does buying an annuity in a retirement plan provide extra tax benefits?
Buying an annuity within an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. Choose your annuity based on its other features and benefits as well as its risks and costs, not its tax benefits.

OTHER INFORMATION

What else do I need to know?
Changes to your contract: We may change your annuity contract from time to time to follow federal or state laws and regulations. If we do, we'll tell you about the changes in writing.

Compensation: We pay the salesperson and the firm he or she is associated with for selling this annuity to you. The compensation they receive could create a conflict of interest by influencing them to recommend one product over another. Ask your salesperson for more information.

Free Look: Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract (page ___) **or see page _____ of the annuity prospectus** to learn about your free look period.

What should I know about the insurance company?
XYZ Life Insurance Company offers a wide variety of retirement and financial security products, including life insurance, annuities, long-term care, and disability income insurance. We also are a leading provider of products and services to workplace-based pension plans—both defined contribution and defined benefit plans. Our financial strength is as follows: A+ (A.M. Best); AA (S&P); Aa3 (Moody's); and AA+ (Fitch).

XYZ Life Insurance Company
123 Main Street
Your Town USA
Telephone: 800–123–4567
www.XYZlife.com

Note: The above information is current as the annuity prospectus dated May 1, 2006. This is a summary document. The prospectus contains important information required under the federal securities laws. If you wish to receive a paper copy of the prospectus and supplement material, click here or call 800-123-4567. There is no charge for paper copies.