

May 17, 2010

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

Re: File No. SR-FINRA-2009-070: Response to Comments

Dear Ms. Murphy:

This letter responds to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) to the above-referenced rule filing, a proposal to adopt FINRA Rule 2211 (Communications with the Public About Variable Insurance Products) (the “Proposed Rule”) as a replacement for NASD Interpretive Material 2210-2 (Communications with the Public About Variable Life Insurance and Variable Annuities), which would be deleted. The proposed rule change was published for comment in the Federal Register on December 9, 2009.¹ The Commission received two comments in response to the proposed rule change.²

The commenters expressed general support for the proposed rule change, but had concerns with certain aspects of the proposed provisions governing assumed rate illustrations of variable insurance products. We discuss our responses to these comments below.

Definitions

Paragraph (a)(6) of the Proposed Rule defines “rider” as “an additional provision to a contract or an additional contract that adds or excludes coverage at an identifiable cost.” The CAI noted that some riders do not have an identifiable contract cost, and recommended that FINRA modify the definition to clarify that riders with no explicit cost

¹ See Securities Exchange Act Release No. 61107 (Dec. 3, 2009), 74 FR 65180 (Dec. 9, 2009). The comment period closed on December 30, 2009.

² See Letter from Clifford Kirsch and Susan Krawczyk, Sutherland Asbill & Brennan LLP, for the Committee of Annuity Insurers, to Elizabeth M. Murphy, Secretary, SEC, dated December 30, 2009 (“CAI”); and Letter from James A. Woodman, to Elizabeth M. Murphy, Secretary, SEC, dated December 30, 2009 (“Woodman”).

are included within the definition of “rider.” In response to this comment, FINRA is deleting “at an identifiable cost” from the definition of “rider.”

The CAI and Woodman both observed that the Proposed Rule does not define the term “illustration.” The CAI recommended that a definition be included but did not suggest particular language. Woodman recommended that “illustration” be defined as “a presentation or depiction that includes non-guaranteed elements of a variable insurance product over a period of years and that is used in the sale of the product.”

FINRA does not believe a definition of the term “illustration” is necessary. What constitutes an illustration for purposes of the Proposed Rule will require a facts and circumstances analysis, as is the case today under NASD IM-2210-2. A technical definition of this term could be problematic either because it would be over-inclusive or under-inclusive.

Qualified Plans

Paragraph (e)(2) of the Proposed Rule would require a communication concerning a variable insurance product offered within a tax-qualified retirement plan to include certain disclosures regarding tax-deferred treatment. The CAI commented that it is not clear which communications would be subject to this disclosure requirement, and expressed concern that arguably all variable insurance product communications could be subject to this requirement since any variable product might be eligible for purchase through a qualified plan. The CAI recommended that this disclosure requirement be limited to communications that refer specifically to tax-qualified retirement plans.

In response to this comment, FINRA is revising the lead-in language in proposed paragraph (e) as follows: “Any communication concerning a variable insurance product that references a tax-qualified plan or that is targeted to participants in such a plan: ...” This new language would limit the application of proposed paragraphs (e)(1) and (e)(2) to situations in which the communication either references a tax-qualified plan or is targeted to participants in such a plan. FINRA would consider a communication to be targeted to participants in such a plan if the communication is distributed primarily to plan participants.

Variable Insurance Product Illustrations

Paragraph (g) of the Proposed Rule would permit a firm to present in communications a hypothetical illustration based on an assumed rate of return to demonstrate the way a variable insurance product operates, subject to certain enumerated conditions. Both the CAI and Woodman had a number of comments on proposed paragraph (g).

Illustrations Format

Proposed paragraph (g)(2) would require that illustrations for variable annuity contracts be presented in a format that depicts, at a minimum, year-by-year account values. The CAI commented that this provision should be revised to allow firms the flexibility to choose which years (after a minimum number of the first ten years) to illustrate as long as such years are clearly disclosed.

FINRA notes that SEC Form N-6 allows hypothetical illustrations to be included in registration statements for separate accounts that offer variable life insurance contracts so long as they meet certain requirements. One of these requirements is that the illustration provide values for contract years one through ten, for every five years beyond the tenth contract year, and for the year of contract maturity.³

Given that this format is permissible for illustrations contained in variable life insurance contract registration statements, FINRA is amending proposed paragraph (g)(2) to permit a similar format for hypothetical illustrations of variable annuities and variable life insurance contracts. As revised, proposed paragraph (g)(2) would allow firms to present illustrations of periods exceeding ten years that depict year-by-year account values for contract years one through ten, for every five years beyond the tenth contract year, and for the final year of the time period illustrated.

Deduction of Maximum Guaranteed Charges

Proposed paragraph (g)(5) would require an assumed rate illustration to reflect the deduction of a product's maximum guaranteed charges for each assumed gross annual rate of return. Proposed paragraph (g)(5) also would permit an illustration to show for each assumed gross annual rate of return results that are net of a product's current charges in addition to the maximum guaranteed charges.

The CAI recommended that the Proposed Rule be modified to eliminate the requirement to show returns net of a product's maximum guaranteed charges. The CAI suggested as an alternative requiring narrative disclosure regarding a product's maximum charges, or only requiring deduction of the maximum guaranteed charges for an illustration of one assumed rate of return, but not all rates of return.

³ See SEC Form N-6, Item 25(e) (Illustrations, Years). Form N-6 is to be used by separate accounts that are unit investment trusts that offer variable life insurance contracts to register under the Investment Company Act of 1940 and to offer their securities under the Securities Act of 1933.

FINRA previously considered this comment in response to Regulatory Notice 08-39.⁴ As we noted then, NASD IM-2210-2 currently requires a variable product illustration to show returns net of the product's maximum guaranteed charges, and we see no reason to relax this requirement. The purpose of an assumed rate illustration is to show how the product would perform based on certain assumptions. FINRA believes that, where a firm elects to present an illustration, the investor should have available an illustration showing what would happen if the product's expenses were increased to the maximum permissible level. Accordingly, we see no reason to revisit our prior conclusion.

The CAI also expressed concern with "the requirement that hypothetical illustrations for variable products include an illustration reflecting a contract's most expensive rider." The CAI noted that particular riders may not apply to the contract that a customer is considering to purchase, and the inclusion of that illustration may be confusing.

Proposed paragraph (g)(5) does not require an illustration to reflect a contract's most expensive rider. The CAI's concern may be based on FINRA's response to comments on Regulatory Notice 08-39, in which we responded to an inquiry as to how the definition of "maximum guaranteed charges" would apply to a contract that has optional features that are not riders to the contract. FINRA stated that it "would expect firms to select the most expensive option in calculating a contract's maximum guaranteed charges."⁵

Our response to this inquiry was based on the assumption that a contract had optional features that are not riders to the contract. We did not intend to suggest that an illustration always must reflect a contract's most expensive rider. Rather, the Proposed Rule requires that the maximum guaranteed charges be deducted for whichever rider is the subject of an illustration. Moreover, even in the context of a contract that has optional features that are not riders, FINRA would not object to an illustration reflecting a less expensive optional feature if the client receiving the illustration intends to select that option.

Negative Assumed Rates of Return

Proposed paragraph (g)(7)(B) would permit an illustration that shows investment results that are based on an assumed negative gross annual rate of return, provided that the illustration also shows results that are based on an assumed positive gross annual rate of

⁴ See Regulatory Notice 08-39 (FINRA Requests Comments on Proposed New Rules Governing Communications About Variable Insurance Products) (July 2008).

⁵ See Securities Exchange Act Release No. 61107 (Dec. 3, 2009), 74 FR 65180, 65184 (Dec. 9, 2009).

return of at least 5% and not more than 10%. Woodman commented that the requirement also to show returns based on a positive assumed rate of return is unnecessary, given the rarity of negative rate illustrations and the fact that most clients will have already seen an illustration based on a positive rate of return.

FINRA previously revised this provision in response to comments on Regulatory Notice 08-39 to eliminate the requirement to show results based on an assumed 0% gross annual rate of return, as otherwise required by proposed paragraph (g)(1). We do not believe it makes sense also to eliminate the requirement to show results based on an assumed positive rate of return. Because historically, over the long run, securities markets have had a positive return, we believe it would be misleading to indicate that markets will always go down, as an illustration with only an assumed negative rate of return might suggest.

Multiple Assumed Rates of Return

Proposed paragraph (g)(7)(C) would permit an illustration that shows investment results that are based on the actual performance of an appropriate broad-based securities market index for the period shown by the illustration. The broad-based index would have to be one that is used as a basis for comparison in discussions of fund performance in the prospectuses of available investment options. The illustrations would have to include certain disclosures, and the index's performance would have to be current as of at least the most calendar year ended prior to the date of use of the illustration.

The CAI requested that the Proposed Rule be revised to permit the use of blended index rates, such as an illustration based 50% on the S&P 500 index performance and 50% on the NASDAQ index performance. FINRA does not intend to allow the use of blended index performance at the discretion of a firm generally, since we are concerned that this practice could lead to the manipulation of index performance in illustrations. However, FINRA may consider possible exceptions to the general prohibition on the use of blended index rates at a future date, after the rule has been in place for a reasonable period of time and we have developed some history on the use of this provision.

Woodman expressed several concerns with proposed paragraph (g)(7)(C) because of possible firm manipulation of securities index performance. Woodman recommended as an alternative that proposed paragraph (g)(7)(C) allow the performance of a broad-based securities index for a period of no more than 20 years, and if a longer period is shown, the same 20-year performance cycle would have to be repeated. Woodman also suggested another possibility of allowing 20 years of index performance, and then requiring a level assumed rate of up to 10% after that. Woodman expressed concern that an index's performance could exceed 10% per year in certain periods, such as the ten-year period ending in 1999.

While FINRA appreciates Woodman's concerns about potential manipulation from the use of index performance in assumed rate illustrations, we believe that we have requirements that would reduce this possibility. First, the Proposed Rule would require all multiple assumed rate illustrations to reflect index performance that is current as of at least the most recently ended calendar year. Thus, firms would not be able to show index returns for a past period when the index performed exceptionally well, such as the 1990's in the case of equity indexes. Second, firms are required to file all variable product illustrations with the FINRA Advertising Regulation Department under NASD Rule 2210(c). This requirement will allow the Advertising Regulation Department staff to review and potentially prohibit firms from using illustrations that may technically meet the requirements for index performance but are presented in a manner that is not fair and balanced.

Implementation Timeframe

Assuming the SEC approves the Proposed Rule, the CAI urged that FINRA set a compliance date which takes into account the firm resources that will be required to comply with any new requirements, and that minimizes the likelihood that firms would have to discard or revise large volumes of existing materials. FINRA appreciates these factors, and intends to give firms sufficient time to adjust to the new standards for variable products communications.

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FINRA believes that the foregoing responds to the material issues raised by the commenters to this rule filing. If you have any questions, please contact Joseph Savage, Vice President and Counsel, Investment Companies Regulation, at (240) 386-4534; or me at (202) 728-6903.

Sincerely,



Kosha K. Dalal
Associate Vice President and Associate General
Counsel
Office of the General Counsel