

May 31, 2011

VIA E-MAIL

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: File No. SR-FINRA-2011-018  
Notice of Filing of Proposed Rule Change and Amendment No. 1 to  
Adopt NASD Rule 2830 as FINRA Rule 2341 (Investment Company  
Securities) in the Consolidated FINRA Rulebook**

Dear Ms. Murphy:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),<sup>1</sup> in response to *Notice of Filing of Proposed Rule Change and Amendment No. 1 to Adopt NASD Rule 2830 as FINRA Rule 2341 (Investment Company Securities) in the Consolidated FINRA Rulebook* (the "Proposal Notice"), issued by the U.S. Securities and Exchange Commission (the "SEC") on May 3, 2011.<sup>2</sup> The Proposal Notice solicits comment on a rule change (the "Proposed Rule Change") to NASD Rule 2830 (the "Current Rule") proposed by the Financial Industry Regulatory Authority ("FINRA") as part of the consolidation of its Investment Company Securities Rule into the FINRA Consolidated Rulebook as FINRA Rule 2341 (the "New Rule"). The Committee appreciates the opportunity to comment on the Proposed Rule Change.

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<sup>1</sup> The Committee of Annuity Insurers is a coalition of 32 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1982 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

<sup>2</sup> The Proposal Notice was published in SEC Release No. 34-64386, 76 Fed. Reg. 26779 (May 9, 2011).

**Overview of Proposed Rule Change.** We note several ways in which the New Rule would differ from the Current Rule. First, the New Rule would eliminate current provisions in the Investment Company Securities Rule requiring prospectus disclosure of certain “special compensation arrangements,” and instead would impose special, separate disclosure requirements on member firms selling investment company securities. In this regard, the New Rule would require a member firm to provide a specified disclosure (a “pre-sale disclosure”) prior to the time the customer first purchases the investment company securities through the member firm, and to maintain a web page or toll-free telephone number through which additional information would be provided.

Second, the Proposed Rule Change would clarify that “revenue sharing” payments should be treated as “cash compensation,” and would effectively require that cash payments by offerors (generally investment companies and their affiliates) for events covered by non-cash compensation provisions also be treated as “cash compensation” for purposes of the disclosure requirements.

Third, the Proposed Rule Change would impose a one-time disclosure requirement for existing customers holding investment company securities. In the case of existing customers, the pre-sale disclosure would need to be delivered within 90 days after the New Rule’s effective date or prior to the time of the existing customer’s first purchase of investment company securities after the New Rule’s effective date. New customers would have to be provided with these disclosures in paper or electronic form prior to the time that the customer first purchases shares of an investment company through the member.

## **COMMITTEE COMMENTS**

As discussed below, the Committee recommends that FINRA clarify that the New Rule would not apply to investment companies underlying variable annuity separate accounts. In addition, in recognition that FINRA may seek to propose changes to FINRA Rule 2320, the Variable Contracts Rule, at a later date to comport with the changes reflected in the New Rule, the Committee also offers comments on aspects of the New Rule in anticipation of that eventuality.

### **Clarify Exclusion for Investment Companies Underlying Variable Insurance Contract Separate Accounts**

**Proposal.** The New Rule on its face would appear to apply to the sale of mutual funds and exchange-traded funds (“ETFs”). The Proposal Notice acknowledges that the New Rule would not apply to variable insurance contracts which are regulated by FINRA Rule 2320.<sup>3</sup>

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<sup>3</sup> See Proposal Notice, n. 4.



However, neither the New Rule nor the Proposal Notice explicitly addresses whether or not the New Rule would apply to mutual funds and ETFs underlying variable insurance contracts.

**Comment.** The Committee notes that FINRA's long-standing position has been that its Investment Company Securities Rule does not apply to investment companies underlying separate accounts for variable insurance contracts.<sup>4</sup> The Committee is concerned that there may be uncertainty regarding the scope and application of the New Rule to separate accounts for variable insurance contracts if this long-standing position is not confirmed in the course of the proceeding for the Proposed Rule Change. Accordingly, the Committee respectfully requests that FINRA make explicit, in connection with the adoption and implementation of the Proposed Rule Change, that the New Rule does not apply to the investment companies underlying separate accounts for variable insurance contracts, including mutual funds and ETFs.

#### **Consider Overlap with Other Disclosure Initiatives**

**Proposal.** The New Rule would require a member firm to make certain disclosures if, within the previous calendar year, the member firm received or entered into an arrangement to receive, from an offeror, any cash compensation other than sales charges and service fees disclosed in the respective prospectus fee table for investment companies sold by the member.

**Comment.** The Committee believes that the disclosure requirements embedded in the New Rule must be considered in light of other customer disclosure initiatives under consideration and that FINRA should avoid a piecemeal approach to addressing its concerns with customer account and point-of-sale disclosures. For example, late last year, by means of Regulatory Notice 10-54 ("RN 10-54")<sup>5</sup>, FINRA solicited comment on a proposal that would require disclosure of the incentives a member firm or its registered representatives have to recommend certain products, investment strategies or services over similar ones. The Proposed Rule Change does not address how the New Rule's disclosure requirements would dovetail, if at all, with that initiative, or even if the disclosures could be included with other disclosures provided at point-of-sale or account-opening. Moreover, these initiatives are inconsistent in

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<sup>4</sup> See, e.g., NASD Notice to Members 97-48, *NASD Regulation Requests Comment On Amendment To Rules Governing Sale And Distribution Of Investment Company Shares And Variable Insurance Products* (August 1997), soliciting comment on whether underlying funds should be excluded from the operation of the Investment Company Securities Rule, and the rulemaking petition submitted by the NASD proposing amendments to the Investment Company Securities Rule and Variable Contracts Rule, *Proposed Rule Change Relating to Sales Charges and Prospectus Disclosure for Mutual Funds and Variable Contracts* (July 19, 1998), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p000692.pdf>, which amendments were approved by the SEC in 1999, pursuant to an order, *Order Granting Approval of and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 4, 5, and 6 to the Proposed Rule Change Relating to Sales Charges and Prospectus Disclosure for Mutual Funds and Variable Contracts* (October 28, 1999), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p000697.pdf>.

<sup>5</sup> See FINRA Regulatory Notice 10-54, *Disclosure of Services, Conflicts and Duties* (October 2010).



identifying the targeted customer base for the disclosures. RN 10-54 proposed a disclosure for retail investors only; the New Rule appears to apply to all customers, both retail customers and institutional accounts.

Further, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) has directed the SEC to consider several rulemaking initiatives focused on imposing or enhancing point-of-sale conflicts and compensation disclosure by broker-dealers. For example, Sections 913 and 919 of the Dodd-Frank Act authorize the SEC to adopt rules governing various conflicts and compensation disclosures to be provided by broker-dealers (among others) in connection with investment products and services. In addition, in connection with a study on investor financial literacy mandated by the Dodd-Frank Act, the SEC has requested comment on public and private efforts to educate investors.<sup>6</sup>

The Committee is concerned that these various rulemaking initiatives, if individually pursued, will result in multiple, redundant and overlapping – and potentially conflicting – disclosures. The Committee believes that investors would be better served if proposals for enhanced conflicts- and compensation-related disclosure were deferred until a coordinated, integrated approach could be developed. Accordingly, the Committee recommends that the new disclosure requirements in the New Rule be reconsidered or, alternatively, that their implementation be delayed so that a coordinated approach can be followed.

#### **Reconsider Supplementary Material Changing Cash Compensation Definition**

**Proposal.** Proposed Supplementary Material .01 (“SM .01”) to the New Rule would elaborate on the definition of cash compensation to include “cash payments commonly known as ‘revenue sharing’ which are typically paid by the investment company’s adviser or another affiliate of the investment company in connection with the sale and distribution of investment company securities.” In addition, SM .01 would define cash compensation to include such payments whether they are based on assets, sales or any other amount. Thus, payments by an offeror to a member’s annual sales meeting, made in compliance with the non-cash compensation provisions of the Investment Company Securities Rule, would be considered “cash compensation” for purposes of the disclosure requirement. While recognizing that those payments have been permitted by the non-cash compensation provisions, the Proposal Notice asserts that such payments should be covered by its cash compensation disclosure requirements as they raise the same conflict-of-interest issues as other forms of revenue sharing.

**Comment.** The Committee is concerned about the impact of this change to the definition of cash compensation in the New Rule on the analysis of revenue sharing arrangements. The Committee has two concerns. The first concern is that the revenue sharing definition in SM .01

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<sup>6</sup> See *Comment Request on Existing Private and Public Efforts to Educate Investors*, SEC Rel. No. 34-64306, 76 Fed. Reg. 22740 (April 22, 2011), available at <http://edocket.access.gpo.gov/2011/pdf/2011-9829.pdf>.



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differs from the definition of “revenue sharing” that has been followed by the SEC in various enforcement actions.<sup>7</sup> (In these actions, payments covered by the non-cash compensation provisions are to be excluded from the definition of “revenue sharing.”) The Committee believes that many institutions have structured their programs to align with the SEC approach. The second concern is that the definition would differ from the definition in the Variable Contracts Rule. The cash compensation and non-cash compensation provisions in the Current Rule are substantially identical to the cash compensation and non-cash compensation provisions of the Variable Contracts Rule. In addition, they are similar to the non-cash compensation provisions in the Corporate Financing Rule and Direct Participation Program Rule. This similarity is intentional, as acknowledged by FINRA on numerous occasions.<sup>8</sup> However, SM .01 would appear to change the analysis of certain arrangements for investment company securities, in that payments towards meetings would be treated as both cash and non-cash compensation if they came from investment company offerors, but only as non-cash compensation if they came from offerors of variable insurance contracts. Committee members are concerned about the potential for confusion if the Investment Company Securities Rule and Variable Contracts Rule differ in this respect, given the widespread industry practices already in place for disclosing compensation arrangements. The Committee believes that it would be preferable to defer the change to SM .01 until a common definition of “revenue sharing” is adopted for all securities offerings subject to non-cash compensation provisions in FINRA rules.

#### **Allow Alternative Approaches for Notices to Existing Customers**

**Proposal.** The New Rule would require that the pre-sale disclosure be delivered to “existing customers” within 90 days after the New Rule’s effective date or prior to the time of the existing customer’s first purchase of investment company securities after the New Rule’s effective date. The New Rule would also require selling firms to update the webpage/telephone information annually, within 90 days after calendar year end, and promptly whenever the information becomes materially inaccurate.

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<sup>7</sup> See, e.g., *In re Putnam Investment Management, LLC*, Investment Advisers Act Release No. 2370 (Mar. 23, 2005), *In re Oppenheimer Funds, Inc., et. al.*, Exchange Act Release No. 52420 (Sept. 14, 2005), and *In re Deutsche Investment Management Americas, Inc., et. al.*, Exchange Act Release No. 54529 (Sept. 26, 2006), all of which define revenue sharing as payments other than (i) dealer concessions, 12b-1 fees, shareholder servicing payments, or subaccounting payments or (ii) non-cash compensation arrangements as expressly permitted by NASD Rule 2820(g)(4) or Rule 2830(l)(5) (or any successor to either such rule).

<sup>8</sup> See, e.g., *Self Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. to Amend Its Restrictions on Non-Cash Compensation in Connection with Corporate Financing and Direct Participation Programs*, SEC Rel. No. 34-47697 (File No. SR-NASD-68), April 18, 2003, proposing amendments to the Corporate Financing Rule and the Direct Participation Program Rule to codify, among other things, “NASD’s policy and practice of applying Interpretive Material issued by NASD staff relating to the non-cash compensation provisions uniformly and consistently to the Corporate Financing [R]ule, the [Direct Participation Program Rule], the Investment Company [R]ule and the Variable Contracts [R]ule.”

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**Comment.** The Committee urges FINRA to permit member firms to coordinate the timing of the delivery of the pre-sale disclosure to existing customers with other customer information delivery requirements. For example, the Committee believes that member firms should have the leeway to furnish the pre-sale disclosure to existing customers with the mailing of their annual privacy notice or other required annual notice. In this regard, the New Rule should be revised to provide that the pre-sale disclosure be delivered to existing customers within 90 days after the New Rule's effectiveness or a required annual mailing, whichever is later.

**Provide More Flexibility for Implementation**


**Proposal.** According to the Proposal Notice, FINRA recognizes that selling firms will need to modify their systems to comply with the New Rule and accordingly is contemplating that the New Rule would be implemented not more than 365 days following SEC approval.

**Comment.** The Committee appreciates the lead time that FINRA is contemplating for the implementation schedule. The Committee recommends that FINRA also consider coordinating the timing of the implementation of the New Rule with the implementation of other similar customer-related requirements so as not to create additional administrative expenses for FINRA member firms.

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The Committee appreciates this opportunity to comment on the Proposed Rule Change. Please do not hesitate to contact Cliff Kirsch (212.389.5052) or Susan S. Krawczyk (202.383.0197) if you have any questions.

Respectfully submitted,

BY: Clifford Kirsch   
Clifford E. Kirsch

BY: Susan S. Krawczyk   
Susan S. Krawczyk

**FOR THE COMMITTEE OF ANNUITY  
INSURERS**



## APPENDIX A

### THE COMMITTEE OF ANNUITY INSURERS

AEGON Group of Companies  
Allstate Financial  
AVIVA USA Corporation  
AXA Equitable Life Insurance Company  
Commonwealth Annuity and Life Insurance Company  
*(a Goldman Sachs company)*  
CNO Financial Group, Inc.  
Fidelity Investments Life Insurance Company  
Genworth Financial  
Great American Life Insurance Co.  
Guardian Insurance & Annuity Co., Inc.  
Hartford Life Insurance Company  
ING North America Insurance Corporation  
Jackson National Life Insurance Company  
John Hancock Life Insurance Company  
Life Insurance Company of the Southwest  
Lincoln Financial Group  
MassMutual Financial Group  
Metropolitan Life Insurance Company  
Nationwide Life Insurance Companies  
New York Life Insurance Company  
Northwestern Mutual Life Insurance Company  
Ohio National Financial Services  
Pacific Life Insurance Company  
Protective Life Insurance Company  
Prudential Insurance Company of America  
RiverSource Life Insurance Company  
*(an Ameriprise Financial company)*  
SunAmerica Financial Group  
Sun Life Financial  
Symetra Financial  
The Phoenix Life Insurance Company  
TIAA-CREF  
USAA Life Insurance Company