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Jonathan G. Katz, Secretary
U.S Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-6009

RE: Form 19b-4 Petition for Approval of Proposed Rule Change Applying NASD Conduct Rules to the Sale of Unregistered Securities; File No. SR-NASD-00-38.

The American Council of Life Insurers ("Council") is a national trade association with 435 member life insurance companies which represent 79.4% of the life insurance in force at all U.S. life insurance companies and 82.2% of the pension business of those companies. Many of our member companies manufacture and distribute variable annuities and variable life insurance ("variable contracts") through affiliated and independent broker/dealers. Over half of the NASD's 557,000 registered representatives work for broker/dealers affiliated with life insurance companies. Our members create and distribute group variable contracts funding qualified retirement plans. The rule petition would have a profound impact on life insurers and their distributors.

Summary of the NASD Petition for Rule Approval

According to the notice and invitation for comment in Release No. 34-43370 , the NASD proposes to adopt new NASD Conduct Rule 0116 "to enumerate the NASD rules and interpretive materials that apply to exempted securities, including governmental securities, other than municipal securities", and "to codify an NASD staff interpretation that the non-cash

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compensation provisions in NASD Conduct Rule 2820(g) apply to group variable contracts that are exempted securities." The NASD filing stated that the initiative will be beneficial by enabling broker-dealers and interested parties to identify which NASD rules apply to exempted securities in a more efficient manner.

Like a duck moving smoothly on the surface of water while madly paddling underneath, the proposal is more complex than the NASD's simple explanation. In truth, the proposal seeks SEC blessing of a significant enlargement of the NASD's jurisdiction over exempt securities sales never authorized by Congress or the SEC. The NASD's request for approval, therefore, is significantly more than a codification and enumeration of applicable rules and interpretations. For the first time, a long history of unauthorized NASD administrative actions will be open for clear examination by the public and review by the SEC.

Summary of Position

We greatly appreciate the opportunity to share our views on the NASD's request to significantly expand its jurisdiction. The NASD filing raises troubling issues of fact and merit that demand careful scrutiny. In denying the NASD's request for accelerated approval without public comment, the SEC commendably exposed the NASD's request to public inspection.

The SEC should affirmatively deny the NASD's petition for rule approval. Expansion of NASDR jurisdiction would significantly impair competition, and would eviscerate Congressional intent. The petition fails to identify a need for regulatory change. Approval of the filing would ratify a pattern of administrative and procedural abuse.[1]

Other factors also warrant denial of the petition. NASD conduct rules provide little regulatory

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[1]In 1997, NASDR issued Notice to Members 97-27, an interpretation applying its conduct rules to a registered representative's sale of unregistered variable life or annuity contracts to qualified retirement plans. This interpretation conflicted with Congressional intent, and was not approved by the Securities and Exchange Commission when it authorized expanded NASD sales-practice authority over exempted government securities, as defined in Section 3(a)(12) of the Securities Exchange Act of 1934. The limited expansion of authority was noticed for comment in Notice to Members 94-62, and the SEC's approval was published in Notice to Members 96-86. The SEC only approved authority to regulate the sale of unregistered government securities, not other categories of exempt securities. Nonetheless, the NASD asserted jurisdiction and applied its position in broker-dealer inspections and interpretive letters.

value to the sale of unregistered variable contracts that fund qualified retirement plans.[2] These contracts are extensively regulated by the Department of Labor under the ERISA statute, by state insurance commissions under comprehensive regulatory structures, and by other federal laws. Redundant layering of NASD conduct rules in this area is expensive and unnecessary. Moreover, institutions purchasing unregistered variable contracts can be justifiably distinguished from retail customers worthy of NASD protection.

The SEC can exercise meaningful scrutiny of the NASD rule petition by addressing four fundamental questions:

- Does the proposed NASDR action unreasonably impair competition?
- Would enlargement of the NASDR's jurisdiction comport with Congressional intent?
- Is there any compelling regulatory need for the NASDR's proposed action?
- Are unregistered variable contracts funding qualified retirement plans adequately regulated under other federal and state structures?

I. THE NASD PROPOSAL WOULD UNDERMINE CONGRESSIONAL INTENT AND THWART THE ADMINISTRATIVE PROCESS

LEGISLATIVE BACKGROUND TO THE NASD'S ACTION

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[2] Variable contracts funding qualified plans have a carefully tailored status under the federal securities laws. In 1970, Congress amended § 3(a)(2) of the Securities Act of 1933 and §3(a)(12) of the Securities Exchange Act so that they exempt "any security arising out of a contract issued by an insurance company" in connection with employee plans that qualify under certain sections of the Internal Revenue Code, such as §401. Congress also amended § 3(c)(11) of the Investment Company Act of 1940 in 1970 to exclude the same plans from the definition of "investment company." Congress enacted these provisions concerning variable contracts because of the regulatory structure of ERISA and state insurance laws, among other things. *See*, Loss and Seligman, *Securities Regulation*, Vol. II at 1015 (1993); *accord*, Loss and Seligman, *Fundamentals of Securities Regulation* at 273 (1994). The history of variable contracts under the federal securities laws is important in evaluating the application of NASD Conduct Rules.

In 1991, federal banking and securities regulators discovered profound abuses in the government securities markets. Some broker/dealers exaggerated the size of customer orders in order to obtain a greater allocation of the government securities competitively auctioned. This conduct threatened public confidence in the fairness and integrity of the government securities market. In response, Congress enacted the Government Securities Act Amendments of 1993 ("GSAA") and "provided the NASD and bank regulators with the authority to issue rules aimed at preventing fraudulent or manipulative acts and practices and to promote just and equitable principles of trade in the government securities market."

This legislation eliminated a prior statutory limitation on the NASD's authority to apply its sales practice rules to transactions in government securities, which are included within the definition of "exempted securities" under Section 3(a)(12) of the Securities Exchange Act of 1934. Prior to the legislation, the NASD was precluded from subjecting its conduct rules to any of the securities defined as "exempted securities."

The House Report on the GSAA states that "it is appropriate to extend normal sales practice standards and other registered securities association roles to transactions in the government securities market by removing the statutory restrictions on the authority of such associations in the government securities market."[3]

There is no mention of variable contracts in the legislative history supporting the statutory amendments or in the administrative history surrounding the NASD's rule change up through NASD NTM 96-66. The NASD's interpretation in Notice to Members 97-27 applied the conduct rules to unregistered variable contracts[4] with a dearth of analysis. This broad application is at odds with the

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[3]H.R. Rep. 103255, 103d Cong, First Sess. (1993).

[4]Section 3(a)(12)(A)(iv) of the Securities Act of 1933 includes as an exempted security "any interest or participation in a single trust fund, or a collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, which interest, participation or security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph." Subparagraph (C) defines the term "qualified" to mean (i) a stock bonus, pension, or profit-sharing plan which meets the requirements for the deduction of the employer's contribution under Section 404(a) (2) of such Code, or (iii) a governmental plan as defined in Section 414(d) of such Code which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used

NASD's regulatory charge.

NASD EXERCISE OF JURISDICTION ABUSES CONGRESSIONAL INTENT

The variable contracts manufactured and distributed by life insurance companies to qualified retirement plans are not the source of market conduct or sales practice abuses. Nothing in NTM 96-66, the SEC's rule approval, NTM 97-27, or the GSAA identify variable contracts as a source of market or regulatory concern. These variable contracts are generally subject to the jurisdiction of the Department of Labor under ERISA, and must satisfy a comprehensive network of state insurance statutes, regulations and policy form approvals. The legislative history of the GSAA unequivocally and exclusively focuses upon government securities and government securities dealers. The greatly enlarged application of the initiative to cover all exempted securities conflicts with the intent and spirit of this important, and specifically focused, legislation.

The following direct quotes from the Senate Report on the GSAA unequivocally confirm that the legislation was intended to govern only government securities broker/dealers, and no other category of exempted securities:

- The Government Securities Act Amendments of 1993 has five major purposes. First, the legislation permanently extends the authority of the Department of the Treasury (Treasury) to write specified rules for *government securities* brokers and dealers. Second, the legislation authorizes the National Association of Securities Dealers (NASD) and the appropriate regulatory agencies for financial institutions to develop and implement sale practice rules for *government securities* brokers and dealers.[5]

- More recently, the GAO and some other commentators, while noting that incidences of abusive sales practices have not been widespread have expressed concerns that the absence of fair-dealing rules makes transactions in *government securities* potentially vulnerable to abusive

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for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (i), (ii), or (iii) of this subparagraph which (i) covers employees some or all of whom are employees within the meaning of Section 401(c) of such Code, or (ii) is a plan funded by an annuity contract described in Section 403(b) of such Code.

[5]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 303 (*emphasis added)*.

dealer practices.[6]

! The legislation addresses these concerns by providing authority to apply sales practice rules to *government securities* brokers and dealers that are not already subject to such rules. For financial institutions that are *government securities* brokers or dealers, the appropriate regulatory agency would be authorized to write rules "necessary to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade." For securities firms that are *government securities* brokers and dealers and members of the NASD, the NASD would be authorized to write sales practice rules, subject to approval by the SEC.[7]

! In addition, if the Treasury determines that an existing rule promulgated under this authority has an adverse effect on the liquidity or efficiency of the market for *government securities* or imposes an unnecessary burden on competition, the Committee intends that these concerns would be appropriately resolved by the appropriate parties.[8]

! In his testimony before the Securities Subcommittee in 1991, Treasury Under Secretary Glauber said, "The magnitude and the severity of abusive sales practices in the *government securities* market are difficult to assess, given the lack of specific evidence of widespread abuse." He noted, however, "Treasury clearly wants to prevent unscrupulous brokers and dealers who may have operated in *** other markets *** from moving into the *government securities* market."[9]

! SEC Chairman Breeden testified that, while the NASD has brought several disciplinary actions for fraudulent sales practices in connection with the sale of *government securities*, "the SEC's own broker-dealer examination program has not found significant sales practices abuse by

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[6]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 303 (*emphasis added)*.

[7]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 303 (*emphasis added)*.

[8]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 303 (*emphasis added)*.

[9]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 309 (*emphasis added)*.

broker-dealers selling *government securities*." Nonetheless, he said removing the prohibition in current law that prevents the NASD from applying its sales practice rules to its members' *government securities* activities is a "reasonable way to improve investor protection."[10]

- Joseph Hardiman, President of the NASD, testified, "[A]s the *government securities* markets have grown in size and complexity, the potential for abuse has been increasing, especially as individual, municipal and small institutional investors in recent years increasingly seek what they believe is greater safety in investments related to a government security." But, he noted, "Abuses in the *government securities* markets generally do not involve primary dealer activity in purchasing those securities from the government and then selling them to sophisticated institutional buyers or other dealers." He said the problems area is in the secondary market, "mostly involving unsophisticated institutional and individual customers."[11]

- Federal Reserve Governor LaWare expressed concern that "suitability rules could impose a burden on the *government securities* market by adding to cost, delaying the execution of transactions and potentially limiting the range of legitimate investments available to a dealer's customers."[12]

- There was broad agreement on the desirability of lifting the restriction on the NASD, which currently prevents the organization from applying its sales practice rules to the *government securities* activities of its members. Accordingly, the legislation reported by the Committee removes current restrictions on the NASD under Section 15A(f)(2) of the Exchange Act by giving a registered securities association authority to write rules "to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade" with respect to the *government securities* activities of its members. The Committee notes the testimony of Joseph Hardiman, President of the NASD, who said the NASD "has historically applied its sales practices requirements with substantial input from the securities industry."[13]

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[10]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 309 (*emphasis added)*.

[11]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 309 (*emphasis added)*.

[12]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 309 (*emphasis added)*.

[13]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 310 (*emphasis added)*.

- The legislation requires that, prior to the adoption or amendment of *government securities* sales practice rules by an appropriate regulatory agency for financial institutions, and prior to the SEC's approval or amendment of NASD *government securities* sales practice rules, the appropriate regulatory agency or the SEC must "consult with and consider the views of" the Treasury, except where an emergency exists requiring expeditious and summary action, and the reasons for taking such action are published.[14]

- At the same time, the Committee recognizes that the Treasury, with its strong interest in minimizing the cost to the taxpayer of financing the government debt by maintaining the liquidity, efficiency, and integrity of the *government securities* market, is positioned to evaluate the actual or potential impact of sales practice rules on the liquidity and efficiency of the market.[15]

- Instead, the Committee intends that the regulatory structure contained in the legislation will encourage the regulatory agencies for financial institutions, the self-regulatory organizations, the SEC and the Treasury to work together as sales practice rules are considered and developed. Such cooperation will assist in ensuring that rules that are adopted are necessary and appropriate, offer consistent protection for investors in transactions with differently regulated entities, will not impair the liquidity or efficiency of the *government securities* market, and will not impose undue costs upon market participants.[16]

- In granting sales practice rulemaking authority to the NASD (subject to SEC oversight) as well as to the appropriate regulatory agencies for financial institutions, the Committee does not expect that sales practice rules applicable to different types of *government securities* brokers and dealers — e.g., financial institution dealers and other securities dealers — necessarily would be identical or even that all appropriate regulatory agencies would adopt sales practice rules. However, the Committee intends that there be consistent levels of protection for

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[14]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84,311, (*emphasis added)*.

[15]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 At 84,311, (*emphasis added)*.

[16]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84,311, (*emphasis added)*.

investors in *government securities*.[17]

The following direct quote from the section by section analysis in the Senate Report on the GSAA is also unequivocal that the purpose of the legislation was to give the NASD authority to bring within its Rules of Conduct only Broker/dealers in *government securities* and not other categories of exempted securities, such as variable contracts distributed to qualified retirement plans:

- *Subsection (b). Rules by Registered Securities Associations.*-- This subsection amends Section 15A(f)(2) of the Exchange Act to give a registered securities association (the NASD) authority to write rules "to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade" with respect to transactions in *government securities*.[18]

CONFLICTS WITH SRO RULEMAKING AUTHORITY AND ANTI-COMPETITIVE CONSEQUENCES

There are several additional benchmarks for evaluating the NASD's request for rule approval. Changes to the NASD's Conduct Rules must comport with the provisions of Section 15A(b)(2) and 15A(b)(6) of the Exchange Act. Securities activities provide the fundamental threshold for these statutory provisions concerning self-regulatory rules. SRO rules, therefore, must have a tangible nexus to securities activities within the NASD's jurisdiction. Congress specifically addressed this issue when it amended the Exchange Act in 1975 concerning the rulemaking authority of self-regulatory organizations. The 1975 Senate Committee Report on this statutory amendment states that:

> The growing diversification of securities firms into non-securities activities has raised, and will continue to raise, significant questions about the adequacy of the present regulatory structure. However, the diversification of securities firms should not automatically extend the jurisdiction of the self-regulatory agencies. Until it is specifically demonstrated to the Congress that non-securities activities of firms which are members of self-regulatory agencies should be limited or regulated in the public interest, such firms should be free to undertake and pursue these

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[17]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 311, (*emphasis added)*.

[18]S. Rep. No. 103-109, 103rd Cong., 1st Sess. (July 27, 1993), reprinted in Fed. Sec. L. Rep. (CCH)[1993 Trans. Binder] ¶85, 215 at 84, 318, (*emphasis added)*.

activities in the same matter as other business organizations, subject only to those regulatory limitations necessary to assure protection of public investors and the public interest. [19]

Similarly, the legislation requires the SEC's Chief Economist to prepare an economic analysis report on each proposed SEC regulation that would be provided to each SEC Commissioner and published in the Federal Register before the regulation became effective. Congress indicated its hope "that this report will demonstrate serious economic analysis throughout the process of developing regulations."[20]

There are several other important guideposts to evaluating proposed rulemaking under the Exchange Act and helping to intelligently balance the costs and burdens of compliance against the goals of new regulation. When it amended the Exchange Act in 1975, Congress specifically charged the SEC with the responsibility to evaluate competitive burdens of SRO rules and rule changes. The Senate report on the legislation stated that:

> Sections 6(b)(8), 19(b) and 19(c) of the Exchange Act would obligate the Commission to review existing and proposed rules of the self-regulatory organizations and to abrogate any present rule, or to *disapprove any proposed rule*, having the effect of a competitive restraint it finds to be neither necessary nor appropriate in furtherance of a legitimate regulatory objective.[21]

Section 23(a) of the Exchange Act was also added in 1975, and requires the SEC to consider the anti-competitive effects of rule changes, and to balance any impact against the regulatory benefit to be obtained.[22]

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[19]S.Rep. No. 75, 94th Cong. 1st Sess. 27-28 (1975). Similarly, in the Capital Markets Efficiency Act of 1996, Congress added Section 3(f) to the Exchange Act requiring that whenever engaged in rulemaking under the Exchange Act, the SEC should "consider, in addition to the protection of investors, whether the action will promote efficiency, *competition* and capital formation."[*emphasis added*] Pub. Law 104-290, 110 Stat. 3416 (October 11, 1996).

[20]S. Rep. 293, 104th Cong., 2d Sess. (June 26, 1996) at 16, 33. This statutory change requires the SEC to conduct an economic analysis of all new regulations before they can enter into effect, potentially reducing the impact of future SEC regulations on the economy. *Id.* In his testimony on this legislation, SEC Chairman Levitt emphasized that "an appropriate balance can be attained in the federal - state arena that better allocates responsibilities, reduces compliance costs and facilitates capital formation, while continuing to provide for the protection of investors." *Id.* at 2.

[21]S. Rep. 94, 94th Cong., 1st Sess. (April 14, 1975) at 12.

[22]*Id*. at 12.

Measured against these numerous statutory benchmarks, the expansion of the NASD's authority beyond the government securities category of exempted securities needs to be carefully scrutinized. The proposed NASD conduct rule conflicts with the intent of Congress in GSAA. Further, the expansion of the initiative beyond government securities dealers appears to contravene the limitations Congress created for SRO rules when it amended Sections 15A(b)(2) 15A(b)(6), 19(b) and 19(c) of the Exchange Act.

Contrary to the NASD's assertion in its filing, the SEC's approval of the NASD rule change in NTM 96-66 did not consider the burden, expense and impairment of competition that the initiative imposes on manufacturers of exempted securities other than government securities that are already subject to comprehensive schemes of regulation.[23] NASD NTM 97-27 was never approved by the SEC. The multiple, unnecessary layering of regulation caused by proposed Rule 0116 and the codification of NTM 97-27 creates an anti-competitive burden contrary to the provisions of the Exchange Act cited above. Further, these actions significantly impair marketplace competition to the detriment of consumers by reducing product choices, and increasing costs in the distribution of variable contracts to qualified plans by salespersons who are NASD registered representatives

MARKET IMPEDIMENTS

NASD Notice to Members 97-27 caused profound disruption in the marketing of variable contracts to qualified retirement plans. The NASD's petition for rule approval would exacerbate and perpetuate this phenomenon. This market has not been the source of any patterns of abuse or market conduct deficiencies. Nevertheless, Notice to Members 97-27 has significantly curtailed the distribution of these variable contracts for two marketplace participants: life insurance companies manufacturing variable contracts distributed to qualified retirement plans, and state licensed insurance products salespersons who also act as registered representatives of a broker/dealer. The respondents to our survey have noted the following marketplace impairments attributable to Notice to Members 97-27.

- Life insurers have suffered a significant curtailment in their traditional, and often decades old, distribution networks as broker/dealers have precluded or greatly limited the ability of registered representatives to recommend the purchase of suitable variable contracts

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[23]The SEC's approval of the NASD interpretation published in NTM 96-66 never evaluated the significant burden and expense of the NASD's action on unregistered variable contracts issued by life insurers. Of course, it is not surprising that the NASD never elicited evaluation by SEC (or the public) on economic or competitive burdens imposed on variable contracts, because the administrative history mentioned only government securities, not variable contracts.

from among the full range of products available. After NTM 97-27, broker/dealers actively issued cease and desist letters concerning variable contract sales to qualified plans.

- Some broker/dealers are unable to obtain distribution agreements allowing their registered representatives to sell certain issuer's variable contracts. Some registered representative's broker/dealers have declined to accept distribution agreements from broker/dealers affiliated with life insurers manufacturing the variable contract, even though the registered representatives had successfully marketed the contract for many years. Together, these factors jettisoned productive, longstanding business relationships in channels of distribution that had been time consuming and expensive to develop. None of the broker/dealers declining to grant or accept distribution agreements cited market conduct or regulatory deficiencies as casual factors.

- Life insurers largely dependent upon independent distributors and that lack direct affiliation with broker/dealers have been particularly hard hit by the fallout from Notice to Members 97-27, as the bulk of their distribution networks have effectively disintegrated following Notice to Members 97-27. In their words, "we have been shut down."

- Several companies have reported the termination of several large variable annuity cases that were near closure with large retirement plans due to Notice to Members 97-27. The terminated business forfeited extensive relationships that had been developed over many months by salespersons in full compliance with ERISA and state insurance laws, who were unable to obtain requisite distribution agreements. In some instances, the employer simply purchased the same issuer's contract from a salesperson not subject to the NASD's jurisdiction, and who did not contribute to the sales effort. In other cases, the issuer lost the sale altogether as retirement plans selected a competitor's variable annuity not subject to the duplicate distribution constraints and delays of the NASD's conduct rules.

SIGNIFICANT ANTI-COMPETITIVE IMPACT

Notice to Members 97-27 has irreparably burdened competition to the detriment of the marketplace, salespeople, variable annuity issuers, and broker/dealers alike. The same would hold true of the SEC approves the NASD's Rule 19b-4 filing. As with the example cited above, these real-life observations were drawn from our insurers' active discussion with many registered representatives, their own group field force, other insurance companies, and broker/dealers.

- Qualified retirement plans now have fewer variable contracts from which to choose because the salesperson's broker/dealer was unable to obtain, or unwilling to grant, a distribution agreement. As a result, the market for these products may become more shallow, less active, and less competitive.

- According to our survey, some registered representatives intend to surrender their NASD registration in order to be able to market variable annuities to qualified retirement plans without the artificial, expensive, and burdensome constraints produced by NTM 97-27. The waste of resources, training, and education caused by these decisions will unnecessarily impact customers, broker/dealers, and competition.

- Following NTM 97-27, some companies report that registered representatives have begun to change their broker/dealer affiliation as they pursue the best compensation arrangement. Unproductive disruptions have occurred as existing business transactions and relationships have moved from broker/dealer to broker/dealer.

- Distribution systems in this market that are outside the NASD's jurisdiction will end up with measurably lower costs of distribution, which will provide an artificial competitive advantage, due to increased compliance expenses and increased compensation cost in order to retain an equal presence in the marketplace.

- NTM 97-27 creates an entry barrier for new pension issuers who have not developed distribution economies of scale. New pension issuers must establish compliance procedures fulfilling Department of Labor and state insurance requirements for all pension products. In order to reach salespeople who also happen to be NASD registered representatives, these issuers will be required to meet additional, duplicate compliance procedures. Some companies expect that these added expenses will be absorbed into the product pricing and passed on to consumers, making the product less efficient.

- Limited purpose broker/dealers, such as those affiliated with life insurance companies, often have low, competitive operating margins. The added expense to support supervision of pension products will either require a substantial reduction in the salesperson's compensation, or could prevent the broker/dealers from accepting pension products for distribution. In either case, the burden on small broker/dealers operating on thin margins is not substantiated by any regulatory need to address concrete regulatory problems.

- ! A substantial company has seriously considered withdrawing from this marketplace entirely because it expects broker/dealers affiliated with other insurers will not allow a selling agreement for a direct competitor's product. The company is currently servicing about 1500 qualified plans with assets of nearly 1.5 billion dollars covering about 200,000 participants, and relies primarily upon distribution by insurance agents of other life insurance companies which are not active in the qualified plan marketplace or whose products are not as competitive. The NASD's nebulous goals pale in comparison to this severe market disruption.

- ! Under NTM 97-27, new products take longer to reach consumers due to the triple layers of state insurance, Department of Labor, and NASD regulation. Each regulatory structure imposes its unique, but often redundant, compliance and approval structures. Further, potential conflicts between the rules promulgated by state, federal and self-regulatory agencies may stall and confound good faith compliance efforts. Ironically, while the securities industry regulators are moving to eliminate regulatory duplication between federal and state authorities, NTM 97-27 moves the insurance industry in the opposite direction. On balance, the NASD's action raises the cost of doing business for all by inserting non-value added layers with a great disruption in the process. Simply stated, on a cost benefit analysis, NTM 97-27 fails.

STIMULUS TO NON-UNIFORM PRACTICES

The interpretive confusion and marketplace disruption of NTM 97-27 has caused a subculture of ad hoc arrangements. A similar result would occur with SEC approval of the NASD's petition for rule approval. The NASD's action thwarts consistent, uniform practices because this market fits poorly in the NASD conduct rules. Implementation of NTM 97-27 has already created extensive member to member differences and disagreements that will expose broker/dealers to unnecessary risks of non-compliance and liability.

For example, following NTM 97-27, at least four "levels" of compensation trends have appeared without a corresponding change in the value to customers.

- ! Salespersons outside the NASD's jurisdiction will receive full compensation from the variable annuity issuer, as occurred before NTM 97-27.

- ! Broker/dealers affiliated with an insurance companies are likely to pass full compensation on to the registered representative on proprietary products. A few broker/dealers reportedly have taken a nominal haircut on proprietary

products to cover added compliance expenses imposed by NTM 97-27.

- ! On non-proprietary products, registered representatives' compensation has experienced haircuts of 10 to 20 percent to cover full supervisory expenses.

- ! Some companies report that several broker/dealers affiliated with life insurance companies have indicated a commission haircut up to 50% on non-proprietary products.

These artificial compensation arrangements bear little rational relationship to product differences or their distribution. Such differences in distribution do not benefit consumers, and contribute to pricing differences where no additional value has been added.

Direct Impact on the Costs of NASD Membership

Broker-dealers must file cyclical FOCUS reports with the NASD aggregating total commissions paid on securities sales. NASD membership fees are a product of the total annual business reflected on the FOCUS reports. When it significantly enlarged the scope of unregistered securities subject to NASD rules in NTM 97-27, the NASD also enlarged the aggregate business reported on FOCUS reports and, therefore, the cost of NASD membership. As a result, the NASD significantly burdened competition for distributors using unregistered variable contract salespersons who coincidentally are NASD registered representatives for other reasons. The sale of unregistered variable contracts does not require an NASD licence. Therefore, distributors not using registered representatives are subject to lower cost of operation as a result of the NASD's position in NTM 97-27. A similar consequence would result if the SEC grants the NASD's request for rule approval.

DECEPTION IN THE RULEMAKING PROCESS

There is also an important issue of administrative and procedural truth underlying the NASD action. None of the NASD circulations of the rule proposal and adoption mentioned variable contracts funding qualified retirement plans. All the titles, captions and text reference only government securities in NTM 96-66. Even the NASD's November 1996 Regulatory and Compliance Alert references the action as a "*government securities*" rule change. We understand the NASDR's Insurance Affiliated Committee did not have any review or input on the rule change as it evolved. Ordinarily, NASD Committees are given an opportunity to provide analysis when rule changes affect matters within their charge. Some companies report that even the NASDR staff indicated in telephone inquiries after NTM 96-66 that it had no application to the sale of unregistered variable contracts to qualified retirement plans.

The SEC's invitation for comment on the NASD rule change likewise entitled and discussed the initiative in terms of government securities, and not the other categories of exempted securities. A careful reading of the SEC and NASD regulatory discussions fails to lead to the conclusion that the proposal would have any impact on variable contracts funding qualified retirement plans. The SEC's approval of the SRO's rule change was defective under the Administrative Procedure Act because the rulemaking notice exclusively emphasized government securities, and made no reference to other categories of exempted securities covered by the rule change.

Because the scope of the NASD's action was so disguised, it was not surprising that no comments were elicited from insurers or their affiliated broker/dealers during the NASD's promulgation and the SEC's approval of the rule change. Collectively, these deficiencies in captions, discussion, administrative procedure, and committee analysis underscore that the amendments should not apply to unregistered variable contracts that fund qualified retirement plans.

II. Variable Contracts Fulfill a Comprehensive State and Federal System of Regulation

Entities serving the qualified plan market must fulfill a comprehensive network of substantive statutory and regulatory requirements that protect the interests of qualified plans and their participants. These structures include ERISA, state insurance laws, disclosure standards administered by the Department of Labor, federal crime statutes, and federal sentencing guidelines. Many aspects of these federal and state provisions are analogous to standards embodied in the NASD Conduct Rules.

The attached table of regulatory comparison demonstrates that this market is already subject to comprehensive state and federal regulation. Pension plans and their participants are appropriately protected, and no pattern of abuse associated with this market has been demonstrated or even suggested.

ERISA

In several significant regards, the ERISA statute was patterned after the Investment Company Act of 1940 concerning prohibitions against self-dealing, fiduciary duty, and information reporting. As a general standard, employee benefit plans must be operated for the exclusive benefit and solely in the interest of plan participants and beneficiaries. Plan sponsors are subject to high standards of prudence in executing their responsibilities, and are subject to liability for breaches of fiduciary duty that are punishable by severe penalties. Retirement plans funded by variable contract separate accounts must fulfill these rigorous fiduciary and regulatory standards administered by the Department of Labor.

A plan sponsor has a fiduciary duty to select appropriate funding vehicles, such as group variable annuities, and to continually monitor their performance.[24] This responsibility includes a thorough evaluation of the insurance company and the investment manager's experience, and execution of due diligence in ascertaining the manager's good professional character and appropriate licensing. If the fiduciary fails to act prudently and exercise due diligence, the fiduciary is liable to plan participants for any losses attributable to the inexperience of the investment manager.

Quite a number of ERISA standards parallel or subsume NASD approaches to regulation. For example, ERISA requires that a fiduciary act prudently and solely in the interest of and for the exclusive benefit of plan participants and beneficiaries. In addition, ERISA requires that plan assets be adequately diversified.[25] These requirements create a direct analog to NASD suitability standards. As noted above, the duty to monitor the appropriateness of the qualified plan's funding vehicles is ongoing and continuous, not just at the time of acquisition.

The problems of churning and inappropriate replacements are circumscribed under ERISA which requires that a fiduciary act solely in the interest and for the exclusive benefit of plan participants and beneficiaries.[26] In addition, ERISA specifically prohibits a fiduciary from dealing with assets of a plan in his/her own interest or for his/her own account.[27]

In an analog to the NASD's statutory disqualification provisions, ERISA prevents any person who has been convicted of certain crimes from serving: as a plan administrator, fiduciary, trustee, custodian or representative in any capacity of any employee benefit plan; as a consultant or advisor to any employee benefit plan; or, in any capacity that involves decision making authority or custody or control of plan assets.[28]

In another example of regulatory parallels, ERISA grants the Labor Department the power, in order to determine whether any person has violated or is about to violate any provision of ERISA or

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[24]Unlike other suitability standards that are measured only at the time of purchase, ERISA requires plan sponsors to continually monitor the appropriateness of qualified plan funding vehicles. The broad scope of this fiduciary duty is comprehensively discussed in Knickerbocker, *Fiduciary Responsibility Under ERISA* (Michie) (1997).

[25]*See*, ERISA at Sections 404(a), 404(a)(1)(B), and 404(a)(1)(C) (1996).

[26]*Id*. at Sections 404(a).

[27]*Id*. at Section 406(b)(1).

[28]*Id.* at Section 411.

any regulation thereunder, to conduct an investigation, and to require the submission of reports, books, and records, and the filing of data in support of any information required to be filed with the Labor Department. In addition, the Labor Department has the authority to enter business places, inspect books and records, and question persons to enable the Department to determine the facts relative to such investigation.[29] These inspection and examination powers correspond to the authority of the NASD and the SEC to examine registered broker/dealers, and ensure regulatory supervision of qualified plan administration.

Similarly, ERISA requires extensive recordkeeping, and mandates that certain plan administrators must furnish to participants an individual statement containing information about each participant's benefits.[30] Additionally, ERISA requires each administrator of a pension plan to furnish to any plan participant or beneficiary who so requests in writing, a statement indicating, on the basis of the latest available information, the total benefits accrued and the nonforfeitable pension benefits which have accrued or the earliest date on which such benefits will become nonforfeitable.[31]

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[29]*Id.* at Section 504(a).

[30]*Id.* at Section 105.

[31]Section 103 of ERISA requires plan administrators to engage an independent qualified public accountant to conduct such an examination of a financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. This requirement applies to plans covering 100 or more participants, and also mandates that the accountant shall conduct such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant.

Among other things, the annual report required in Section 103 must have information in separate schedules concerning: a statements of the assets and liabilities of the plan aggregated by categories and valued at the current value; a schedule of all assets held for investment purposes aggregated and identified by issuer, borrower or lessor, maturity date in valuation and a schedule of all loans or fixed income obligations.

Section 102(a)(1) requires that the summary plan description for participants and beneficiaries shall be written in a manner calculated to be understood by the average plan participants and shall be sufficiently accurate and comprehensive to reasonably apprize such participants and beneficiaries of their rights and obligations under the plan. This requirement parallels the SEC's plain English initiative. Collectively, these requirements impose high thresholds for monitoring activities involving qualified plans and plan assets, and preventing abusive practices. This parallels SEC and NASD plain English and participant education initiatives.

The application of the NASD's revised "suitability obligations to institutional customers" to variable annuity contracts used to fund qualified plans is also not necessary or appropriate. The fundamental structure of ERISA and state fiduciary laws place the responsibility for the investment of retirement plan assets on plan fiduciaries, who select and monitor institutions managing plan assets and, with respect to 401(k) plans, also assure participant access to a prudent and diverse range of investments for individual accounts. Failure to fulfill these obligations in a prudent manner and solely in the interests of plan participants and beneficiaries subjects the fiduciary to ERISA's enforcement regime.

Under ERISA, a participant, beneficiary or the Secretary of Labor can bring a civil action against the fiduciary who breached his or her duties. The fiduciary is personally liable to make good to the plan any losses resulting from the breach and to restore to the plan any profits that inured to the fiduciary. The fiduciary is also subject to other equitable or remedial relief as a court may deem appropriate.

NASD NTM 96-66 identifies as a reason for extending the suitability requirements the situation where an investor that otherwise meets the definition of "institutional customer" may not possess the requisite capability to understand the particular investment risk, or may not be exercising independent judgment in making a particular investment decision and may, therefore, be largely dependent on the broker/dealer's analysis and recommendation in evaluating whether to purchase a recommended security. ERISA contains a functional definition of "fiduciary". The scenario in NTM 96-66 is broad enough to make the broker/dealer a fiduciary, and thus subject to all of ERISA's fiduciary duties and responsibilities.

The ERISA standards explained above provide rigorous protections and meaningful disclosure for qualified plan participants. In light of these factors, application of the NASD Conduct Rules to variable contracts sold to qualified plans is misplaced.

COMPREHENSIVE NETWORK OF STATE INSURANCE REGULATION

Through a network of statutes and regulations, state insurance departments heavily regulate the operations, products, and sales of life insurance companies. Life insurers and their salespersons must satisfy this regulatory structure in their state of domicile and every jurisdiction in which they distribute life insurance and annuities. Uniformity of regulation is accomplished throughout the states by means of model statutes and regulations promulgated by the National Association of Insurance Commissioners (the "NAIC"). Many of the insurance statutes and regulations promulgated and enforced by state insurance departments fulfill regulatory goals quite similar to those of the NASD. The summary below highlights the broad scope and comprehensiveness of certain state insurance statutes and regulations with parallels to the NASD Rules of Conduct.

UNFAIR TRADE PRACTICES

Virtually every state has enacted a version of the NAIC Model Unfair Trade Fair Practices Act which was developed to regulate trade practices in the insurance business by defining and prohibiting practices that constitute unfair methods of competition or unfair deceptive acts or practices.[32]

A variety of the activities defined to be unfair trade practices directly parallel the purpose and scope of NASD Rules of Conduct. Section 4(A) involves misrepresentations and false advertising of insurance policies, and identifies unfair trade practices to include any estimate, illustration, circular or statement, sales misrepresentation, omission or comparison that misrepresents the benefits, advantages, conditions or terms of any policy, among other things. This provision parallels the purpose of the NASD Conduct Rule 2210 - Communications with the Public.

Section 4(B) involves false information and advertising generally. This provision defines an unfair trade practice to include making, publishing or disseminating in a newspaper, magazine or other publication, on any radio/television station any assertion, representation or statement about an insurer or its business, which is untrue, deceptive or misleading. Section 4(B) also comports with the purpose of NASD Conduct Rule 2210.

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[32]This model statute governs items previously subject to Section 5 of The Federal Trade Commission Act. Congress observed that continued regulation of insurance by the states was in the public interest. *See*, legislative history of NAIC Unfair Trade Practices Act, NAIC Model Regulation Service at 880-20(1993).

Knowingly making any false statement of any material fact to insurance regulators, or in documents that will be publicly disseminated, is defined to be an unfair trade practice in Section 4(B) of the Model Unfair Trade Practices Act. This proscription is consistent with the truthfulness and accuracy of reports, records and representations required of Broker/Dealers by the NASD and the SEC under the federal securities laws.

Section 4(J) involves the failure to maintain marketing and performance records, and defines as an unfair trade practice the failure of an insurer to maintain its books, records, documents, and other business records in such an order that data regarding complaints, claims, reading, underwriting and marketing are accessible and retrievable for examination by the insurance commissioner. Data for at least the current calender year in the two preceding years must be maintained under this standard. This provision directly parallels the scope and purpose of NASD Conduct Rule 3110 regarding books and records.

Section 4(K) defines the failure of any insurer to maintain a complete record of all the complaints it received since the date of its last market conduct examination to be an unfair trade practice. The records of complaints must indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint and the time it took to process each[33]. For purposes of this subsection, the term "complaint" means any written communication primarily expressing a grievance. These standards directly parallel the requirements of NASD Conduct Rule 3110(d) and (e), as well as interpretations that have appeared in the NASD's Notices to Members.

Like the NASD, insurance commissioners have the power to examine and investigate the affairs of every insurer operating in the insurance department's state "in order to determine whether such insurer has been or is engaged in any unfair trade practice prohibited by [the Unfair Trade Practices Act]."[34] Several provisions embellish this important authority.

For example, Section 7 of the Unfair Trade Practices Act gives insurance commissioners extensive authority to initiate hearings concerning unfair trade practices, to compel witnesses, appearances, production of books, and service of process. Section 7 sets forth detailed administrative

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[33]The NAIC has also promulgated a Model Regulation for Complete Records to be maintained pursuant to Section 4(K) of the NAIC Unfair Trade Practices Act. *See*, NAIC Model Regulation Service at 844-1(1992).This regulation sets forth a complaint record form, content requirements, maintenance requirements, and standards concerning the format of complaint records.

[34] *See,* Section 6, Power of Commissioner, Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-9(1993)

and procedural practices, in order to assure due process and quasi-judicial formality.

Section 8 of the Unfair Trade Practices statute authorizes insurance commissioners finding insurers guilty of unfair trade practices to issue written findings and enforcement orders requiring the insurer to cease and desist from engaging in the act or practice. The insurance commissioner also has the discretionary authority to suspend and revoke the insurer's license if the insurer knew or reasonably should have known that its conduct violated the Unfair Trade Practices Act, and to order penalties of $1000 for each violation up to an aggregate penalty of $100,000, unless the violation was committed flagrantly in conscious disregard of the act, in which case the penalty may be up to $25,000 for each violation to an aggregate total penalty of $250,000. A similar monetary violation may be imposed under Section 11 for violations of cease and desist orders. The act also provides for judicial review of insurance commissioner orders and authorizes immunity from prosecution for witnesses who attend, testify or produce books, records or other paper correspondence.[35]

These significant powers that may be used by insurance commissioners to enforce violations of unfair trade practice proscriptions, together with the recordkeeping, reporting and inspection powers of the Act, provide a package of regulatory tools directly analogous to the NASD Rules of Conduct and SEC regulations governing market conduct practices and the prosecution of violations. In a sum, the unfair trade practice laws provide meaningful proscriptions that eliminate the need for duplicative NASD regulation of variable contract sales to qualified plans under the NASD Rules of Conduct.

NAIC MODEL FRAUD LAWS AND FRAUD LEGISLATION

Enactment of state fraud statutes represents another significant insurance regulatory development. Recent market conduct issues have resulted in some insurance departments requiring insurer management to assume increased responsibility for supervision of sales activities. Other states have taken an approach similar to that of New York and Pennsylvania by requiring insurer review of market conduct compliance, thus placing direct responsibility at the corporate officer level. This widespread action dovetails with the objectives of the Federal Crime Control Statute and the Federal Sentencing guidelines, discussed below.

While states have taken different approaches to the issue, the majority of states addressing the fraud issue enacted legislation similar to the NAIC Model Fraud Laws.[36]

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[35] *See* Sections 8, 9, 10, 11 and 14 of the Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-10 through 13(1994).

[36] *See*, NAIC Insurance Fraud Prevention Model Act, NAIC Model Reporting Service at 680-1(1995).

MARKET CONDUCT EXAMINATIONS

Nearly every jurisdiction has enacted a version of the NAIC Model Law on Examinations.[37] This Act is designed to provide an effective and efficient system for examining the activities, operations, financial condition and affairs of all persons transacting the business of insurance in each state and concerning individuals otherwise subject to the insurance commissioner's jurisdiction. The Act is intended to enable commissioners to adopt a flexible system of examinations and allocate resources deemed appropriate and necessary for the administration of the insurance laws of each state. The Model Law on Examinations sets forth standards for the conduct of examinations, commissioner authority, scope, and scheduling of examinations. It also details the scope of examination reports which shall be comprised of only facts appearing on books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined.[38]

Significantly, this Model Act dovetails with the NAIC Market Conduct Examiner's Handbook, an extremely detailed manual for examiners to assure that examiners follow comprehensive, uniform practices and procedures. The Examiner's Handbook is divided into seven different sections and contains 58 different standards. Among other things, the Examiner's Handbook addresses complaint handling, marketing and sales, producer licensing, and company operations/management.[39]

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[37] *See*, NAIC Model Regulation Service at 390-1(1991).

[38] *See,* Sections 3, 4, and 5 of the Model Law on Examinations, NAIC Model Regulation Service at 390-5 (1991). Section 5 also sets forth detailed provisions for orders and administrative procedures in the conduct of hearing and adoption of a report on examination.

[39] Certain standards under the complaint handling section illuminate the depth and scope of the market conduct examination. Several standards are set forth below in this note as representative examples.

Complaint Handling

Standard 2

The company has adequate complaint handling procedures in place and communicates such procedures to policyholders.

Review Procedures and Criteria

Review manuals to verify complaint procedures exist. Procedures in place should be sufficient to require satisfactory handling of complaints received as well as internal procedures for analysis in areas developing complaints. There should be a method for distribution of and obtaining and recording response to complaints. This method should be sufficient to allow response within the time frame required by state law.

Company should provide a telephone number and address for consumer inquiries.

Complaint Handling

Standard 3

The company should take adequate steps to finalize and dispose of the complaint in accordance with

Throughout most of 1995 and 1996, the NAIC significantly revised the Market Conduct Examiner's Handbook, which has been recommended for full adoption by the NAIC. The NAIC, together with industry input, sought to expand and enhance tools fostering the detection and prevention of marketplace abuse in the life insurance industry. Market conduct examinations are extremely comprehensive and serve as a means of positive reinforcement, by discouraging deficient practices that will be detected on examination, resulting in remedial action, and insurance department intervention.

AGENTS LICENSING AND TESTING

The NAIC Agents and Brokers Licensing Model Act[40], which appears virtually in every state, governs the qualifications and procedures for licensing insurance and annuity agents and brokers. This model law sets forth examination and licensing standards in great detail, and has a specific category for variable annuities and variable life insurance contracts. Licensed salespeople must be deemed by the insurance commissioner to be competent, trustworthy, financially responsible, and of good personal and business reputation. Insurance brokers must also fulfill experience requirements. Section 8 of this regulation governs license denial, non-renewal and termination, giving the insurance commissioner broad discretion to suspend, revoke or refuse to issue or renew a license upon finding any of a variety of conditions including materially untrue statements, violation or noncompliance with insurance laws, withholding, misappropriating or converting customer moneys, conviction of a felony or misdemeanor involving moral turpitude, forgery, or cheating on licensing examinations, among other things. Although covering a different subject matter from NASD licensing and testing protocols, the purpose, scope and depth of this insurance examination and licensing network is comprehensive and parallel to the NASD's

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applicable statutes, rules and regulations and contract language.

Review Procedures and Criteria

Review complaints documentation to determine if the company response fully addresses the issues raise. If the company did not properly address/resolve the complaint, the examiner should ask company what corrective action it intends to take.

Commentary:

Reference to the examiner's general instructions on Handbook page VIII-14 (November 1995) reveals that an inquiry broader in scope than the mere resolution of a given complaint is expected. For example, the Handbook contains the following instructions:

"The examiner should review the frequency of similar complaints and be aware of any pattern of specific type of complaints....Should the types of complaints generated be cause for unusual concern, specific measures should be instituted to investigate other areas of the company's operation."

Complaint Handling

Standard 4

The time frame within which the company responds is in accordance with applicable statutes, rules, and regulations.

Review Procedures and Criteria

Review complaints to ensure company is maintaining adequate documentation. Determine if the company response is timely. The examiner should refer to state laws for the required time frame.

[40] *See*, NAIC Model Regulation Service at 210-1 (1990).

analogous licensing and examination practices.

CONTINUING EDUCATION

In granting insurance agents and brokers licenses, most states also impose significant continuing education standards that parallel in objective and scope the continuing education standards recently developed in the securities industry together with the NASD. As in other areas seeking uniformity, the NAIC has promulgated the Agents and Brokers Licensing Model Act.[41] Under Section 5 of this model regulation, licensed agents must annually satisfy courses or programs of instruction approved by insurance commissioners in each state according to a minimum number of classroom hours, which typically is in the range of 25 class room hours per year for life and annuity salespersons. The courses include those presented by the Life Underwriter Training Council Life Course Curriculum, the American College's Chartered Life Underwriter and Chartered Financial Planner curriculum, and the Insurance Institute of America's programs in general insurance, for example. Like the NASD, state insurance regulators understand that testing, licensing and demonstration of continued competence through continuing education is critically important in the distribution of insurance and annuity products.

VARIABLE CONTRACT STATUTES

Life insurance companies are authorized to issue separate accounts funding variable life insurance and annuity contracts upon fulfilling a variable contract statute in their domestic state, which typically follows the NAIC Model Variable Contract Law.[42] This NAIC model statute gives the insurance commissioner exclusive authority to regulate the issuance and sale of variable contracts and to issue rules and regulations appropriate to carry out the act's purpose. This model act and associated regulations that appear under state insurance law gives an additional, important measure of regulatory scrutiny and purchaser protection.

Collectively, the NAIC statutes and regulations provide a significant network of comprehensive regulation over many important aspects affecting the marketing and sale of variable contracts that closely reflect the purpose and scope of analogous NASD rules of conduct, examination procedures and inspection authority. In light of these meaningful regulatory mechanisms, redundant application of the NASD Rules of Conduct to the sale of variable contracts to qualified plans is unnecessary.

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[41]*See* NAIC Model Regulation Service at 215-1 (1990).

[42]*See,* NAIC Model Regulation Service at 260-1 (1984).

INSURANCE PRODUCER DATABASE

From a market conduct perspective, life insurers have committed to a single, industry-accessible national producer database to facilitate their ability to track pertinent information regarding licensed producers. Access to information having a bearing on the producer's background, qualifications and competency is a valuable tool to insurers in the employment/appointment screening process. Moreover, widespread availability of such information makes it more difficult for a producer with significant disciplinary history to continue illegal or unethical practices by "company jumping."

Incorporated in October 1996, the Insurance Regulatory Information Network (IRIN)[43] is a non-profit affiliate of the National Association of Insurance Commissioners (NAIC) that has developed and implemented the Producer Database (PDB). IRIN is governed by a board of directors structured to include five members representing the NAIC and four industry members representing a cross section of the insurance industry.

The PDB is an electronic database consisting of information relating to insurance agents and brokers (producers). The PDB links participating state regulatory licensing systems into one common repository of producer information. The PDB will also access other information sources such as the National Association of Securities Dealers (NASD), the Regulatory Information Retrieval System and others. The PDB also sends an electronic notification to state users if administrative action is taken against a licensed producer in their state or if a producer no longer holds an active resident license. The key benefits of PDB are:

- Immediate access to detailed disciplinary history
- Immediate electronic notification of administrative action
- Verification of licenses and good standing in all participating states

PIN is an electronic communication network that links state insurance regulators with the entities they regulate to facilitate the electronic exchange of producer information. Data standards will be developed for the exchange of license application, license renewal, appointment and termination information. All data flowing over PIN will conform to these standards.

Through the Internet, industry users of the PDB are able to access various types of information regarding producers licensed in participating states, such as demographic information, license status, final disciplinary action taken by a state, certain NASD information if applicable, and letters of certification and clearance.

As of January 22, 1999, producer information from 18 states can be viewed on Internet PDB. These states are AR, CO, CT, FL, IA, IL, IN, MI, MN, NC, ND, NJ, OH, PA, SD, TX, WA, WI.

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[43] Additional information about IRIN can be obtained at its website http://www.irin.org/.

Information provided by North Carolina is currently masked, but should be available by March 1, 1999. All but three states currently provide daily updates. California is expected to begin providing producer information to Internet PDB by the end of the first quarter of 1999, while AZ, DE, ID, KS, KY, LA, NE, NY, TN and VA are in the planning states.

The implementation plan approved by the IRIN Board calls for 38 states to be on the Internet PDB by the lst Quarter of the year 2000. Implementation dates for the remaining states and territories will be set during 1999. IRIN is continuing to provide technical and quality assurance support to the State Licensing and IS departments as they implement a daily update interface to Internet PDB.

In many respects, this new producer data base parallels the purpose and scope of the NASD's Central Records Depository or CRD. Indeed, linkage between the CRD and IRIN exists. Through the IRIN data base, problem producers can be tracked and deterred from the insurance business.

III. Voluntary Market Conduct Endeavor - The Insurance Marketplace Standards Association ("IMSA")

After a comprehensive two-year period of ACLI study and development, the life insurance industry has established the Insurance Marketplace Standards Association ("IMSA"), a voluntary, membership organization for life insurance companies. IMSA provides a practical and conceptual structure to assist its member companies to maintain high standards of market conduct in the sale of individual life and annuity products. The fundamental purpose of IMSA is to facilitate, advance, and promote ethical market conduct in the life insurance industry.

An eligible life insurance company will be admitted to IMSA membership five days after filing with IMSA current reports indicating successful completion of IMSA's Assessment Questionnaire by both the eligible company and by an independent assessor approved by IMSA. An insurance company considering participation in IMSA would first need to evaluate, understand, and adopt IMSA's Principles of Ethical Market Conduct and the IMSA Code of Life Insurance Ethical Market Conduct. The company would then utilize IMSA's Assessment Questionnaire and the Assessor's Handbook to perform a market conduct self-assessment. If the company were able to respond affirmatively to each question in the Assessment Questionnaire, it would then engage an independent assessor to review the self-assessment and to perform an independent assessment following similar procedures. If the independent assessment is successful, the company would then be able to submit reports indicating such success to IMSA and could become a member. Following an advertising moratorium expiring on April 1, 1998, IMSA members were able to advertise their membership and use the IMSA logo. Membership in IMSA is good for a three-year period after which companies must undergo the assessment process anew to retain membership. As of August 4, 2000 IMSA has 240 member companies that collectively represent 82.52% of the market share for individually sold life insurance and annuity business in the United States.

The core of the IMSA market conduct initiative is the commitment of each participating life insurance company to the following Principles of Ethical Market Conduct:

"Each life insurance company subscribing to these principles commits itself in all matters affecting the sale of individually-sold life and annuity products:

1. To conduct business according to high standards of honesty and fairness and to render that service to its customers which, in the same circumstances, it would apply to or demand for itself.

2. To provide competent and customer-focused sales and services.

3. To engage in active and fair competition.

4. To provide advertising and sales materials that are clear as to purpose and honest and fair as to content.

5. To provide for fair and expeditious handling of customer complaints and disputes.

6. To maintain a system of supervision and review that is reasonably designed to achieve compliance with these Principles of Ethical Market Conduct.

The Code of Ethical Market Conduct elaborates in some detail on each of the six principles and includes commentary to clarify application and use of the Principles. The six Principles are supported implementing Code Provisions set forth in a 140-page Assessment Handbook detailing the criteria for interpreting and applying the Principles, Code, and Assessment Questionnaire.

The focus of the self-assessment done by the company and the independent assessment done by the independent assessor relates to whether or not the company has an infrastructure - policies and procedures - that will reasonably assure compliance with the Principles and Code. The program architects developed the IMSA Assessment Questionnaire to test the existence of such an infrastructure and to assist the company and the independent assessor in assessing the company's compliance with the Principles and Code. The Assessment Questionnaire consists of 24 questions. An affirmative answer is required to each of the 24 questions to enable a company to qualify for IMSA membership. There are specific questions regarding each of the Principles.

The IMSA Assessment Handbook is an instruction manual providing objective, systemic, analytical guidance to the company or its independent assessor concerning the details of assessment. In order to respond affirmatively to the 24 questions that comprise the Assessment Questionnaire, the Assessment Handbook requires an affirmative response to an extensive series of questions regarding the company's policies and procedures, the communication and use of those policies and procedures, and the continuing monitoring by the company of the utility of the policies and procedures.

The Assessment Handbook includes a number of "indicators" to guide the assessor and to yield objective information to consider in formulating and evaluating an answer to each question in the

Questionnaire. The indicators are intended to provide examples of how an insurer, regardless of size or complexity, may demonstrate compliance with the Principles and Code. In some cases an insurer may be able to identify alternative indicators not set forth in the Assessment Handbook, which will provide support for the requisite affirmative response to the questions.

The Assessment Handbook also includes various testing procedures by which the company and the independent assessor can examine the company and its personnel in the assessment process. The Assessment Handbook also discusses permissible sampling techniques for assessors, recognizing that reviewing all documents and interviewing all employees and participants may be impractical.

Thus, while there are only six Principles that provide the foundation of the IMSA market conduct effort and only 24 questions comprise the IMSA Assessment Questionnaire, the assessment process is designed to be both comprehensive and flexible. It is designed to compel the company and the independent assessor to produce specific evidence of compliance with both the letter and the spirit of the life insurance market conduct effort.

IV. DOL DISCLOSURE INITIATIVES AFFECTING QUALIFIED PLANS

There have been significant developments at the Department of Labor concerning the range of funding options available to plan participants and the risk attributable to each option, and noteworthy strides in educating plan participants about retirement plan funding alternatives. After careful analysis and critical scrutiny, the Department of Labor issued its Section 404(c) regulations in 1992 that provide plan participants with useful additional information about, and more control over, their investment choices.[44]

In order to rely on the Section 404(c) regulations, a plan sponsor or plan administrator must offer at least three diversified investment vehicles, each of which has different risk and return characteristics. Further, the plan must permit participants to transfer among the vehicles at least once within each three-month period, and more frequently for investment vehicles subject to fluctuating performance patterns.

Significantly, the Section 404(c) rules require the plan sponsor to assure that plan participants are given, or can obtain, the information necessary to make an informed investment decision. At a minimum, sponsors must give employees information about each investment option, including its objectives, risk and return characteristics, and type of portfolio assets, as well as information about transfer procedures, the expenses and performance of each investment option, and a prospectus for vehicles registered under the Securities Act of 1933.

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[44]Section 404(c) under ERISA gives plan sponsors or plan administrators of self-directed plans protection from certain fiduciary liabilities if the conditions of Section 404(c) are followed.

Since adopting the Section 404(c) regulations concerning fiduciary responsibilities for self-directed individual account plans, the Department of Labor issued Interpretative Bulletin 96-1 on June 6, 1996, which provides guidance to encourage employer-provided education for plan participants. The Department of Labor sought to provide a safe harbor for retirement plans delineating the type of investor education that could be provided to plan participants without becoming investment advice. The Department of Labor issued this interpretation in view of the important role that investment education can play in assisting participants and beneficiaries in making informed investment and retirement-related decisions.

Interpretative Bulletin 96-1 identifies four increasingly specific categories of investment information and materials that can be provided within the ambit of investment education. These are plan information, general financial and investment information, asset allocation models, and interactive investment materials. This category includes information and materials that inform a plan participant or beneficiary about (i) general financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compound returns and tax-deferred investment; (ii) historic differences in rates of return between different asset classes (*e.g.,* equities, bonds or cash) based on standard market indices; (iii) the effects of inflation; (iv) how to estimate future retirement income needs; (v) how to determine investment time horizons; and (vi) how to assess risk tolerance.

In October 1998, the Department of Labor published a detailed consumer disclosure booklet on 401(k) plan fees.[45] This Department of Labor action evidences active regulation of qualified plan funding vehicles. The added application of the NASD's rules of conduct is regulatory overkill.

V. OTHER FEDERAL STATUTES ENHANCING COMPLIANCE PROCEDURES AND MARKET CONDUCT

The *Federal Violent Crime Control Act of 1994* ("The Act"), and the *Federal Sentencing Guidelines for Organizations* have an important impact on the prevention of abusive sales practices. Together, these statutes provide material protections for qualified plans and their participants.

Several provisions in the *Federal Violent Crime Control Act of 1994*[46] relate to sales practices within the insurance industry. The law punishes with fines and a jail term up to five years

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[45]On several occasions, the DOL has publicly stated its intent to develop a standardized fee disclosure statement to facilitate comparison among competing funding arrangements for 401(k) plans. *See*, Winokur, *Labor Dept. Is Developing 1-Page Fee Disclosure Form*, American Banker (Nov. 6, 1998) at 6.

[46]Ch. 47, Title 18, U.S.C. at subsection 1033 (1996).

anyone who *participates* in the business of insurance and has been convicted of a felony involving dishonestly or a breach of trust. Likewise anyone convicted of violating the Act itself cannot participate in the business of insurance and is punished with fines and jail. There are fines and jail terms for anyone who willfully allows a person to participate in the business of insurance who has been convicted of a felony involving dishonesty or a breach of trust. Consequently, anyone who willfully *allows* a person who has been convicted of a felony involving dishonesty or a breach of trust to participate in the business of insurance will be prohibited from participating in the business of insurance themselves.

The law applies to all insurance companies, regardless of the lines of business sold or the state of domicile. Persons who *"participate"* in the business of insurance include officers, directors, agents, employees, or persons authorized to act on behalf of such persons. The *"willfully permits"* language means that even if the felony was before the effective date, that person cannot be allowed to continue to participate in the business.

The Federal Crime Control Statute imposes an important prophylactic parallel to the NASD's barrier to statutorily disqualified individuals in the broker/dealer industry. This protection applies to all life and annuity sales, including variable annuities marketed to qualified plans.

Importantly, the *Sentencing Reform Act of 1984* has made a dramatic change in the federal court sentencing system since its enactment.[47] Essentially, the law provides that evidence of effective compliance programs will be regarded favorably as mitigating factors in the imposition of sentence upon a conviction for criminal behavior. The guidelines as provided in the *United States Sentencing Commission Guidelines Manual: Sentencing of Organizations*, are:

> "An effective program to prevent and detect violations of law means a program that been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct. Failure to prevent or detect the instant offense, by itself, does not mean that the program was not effective. The hallmark of an effective program to prevent and detect violations of law is that the organization exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents. Due diligence requires at a minimum that the organization must have taken the following types of steps:
>
> (1) The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.

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[47]The particular provisions noted above are from the *Organizational Sentencing Guidelines*, and took effect on November 1, 1991.

(2) Specific individual(s) within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.

(3) The organization must have used due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities.

(4) The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, *e.g.,* by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required.

(5) The organization must have taken reasonable steps to achieve compliance with its standards, *e.g.*, by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution.

(6) The standards must have been consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense. Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case specific.

(7) After an offense has been detected, the organization must have taken all reasonable steps to respond appropriately to the offense and to prevent further similar offenses -- including any necessary modifications to its program to prevent and detect violations of law."

Significantly, organizations are now strongly motivated to establish compliance standards and procedures and to monitor those procedures through a self evaluative process. Through this process, corporations can reduce exposure to liability, both criminally and civilly. Insurance and annuity consumers benefit from these initiatives.

SUMMARY AND CONCLUSION

Is it necessary to apply the NASD's Rules of Conduct to the sale of variable contracts to

qualified plans in light of the extensive marketplace disruption it causes? For several compelling reasons, the answer is no. Nowhere throughout the initiative, has the NASD demonstrated any abuse in this market needing a remedy. In essence, the NASD's rule petition is a solution in search of a problem. Nowhere in the initiative has the NASD clearly justified its need to act in this market.

Variable contracts marketed to qualified retirement plans are already subject to significant regulation and consumer protection under ERISA, and state insurance statutes and regulations. The application of the NASD's Conduct Rules to this marketplace layers redundant, duplicative regulation on a heavily regulated market, while contributing little value added. Importantly, end-users are protected appropriately by ERISA and state regulatory structures in the manner suited to the market.

The NASD's proposed rule and interpretation do not comport with the intent of Congress when it enacted the Government Securities Act Amendments of 1993. The administrative procedures surrounding the promulgation of Notice to Members 97-27 constituted stealth regulation. The captions and narrative in the NASD's rulemaking refer to government securities broker/dealers, as did the legislative history supporting the statutory grant of authority to the NASD. Many strongly question whether the SEC's approval of the NASD action in Notice to Members 96-66 fulfilled the purpose of the Administrative Procedure Act because it did not accurately describe the rule's impact in the notice for comment.

As a consequence of these factors, the NASD's action lacked meaningful input from broker/dealers affiliated with life insurers as it submitted NTM 96-66 to the SEC for review and approval. Ordinarily both the NASD and the SEC seek to elicit active and thorough input from individuals and entities that will be subject to new rules. The NASD's action was so subtle in its application to variable contracts that no comments were elicited from insurers or their affiliated broker/dealers during the NASD's promulgation and the SEC's approval of the rule change. Some companies report that even the NASDR staff indicated in telephone inquiries after Notice to Members 96-66 that it had no application to the sale of unregistered variable contracts to qualified retirement plans. The SEC should not be a party to the NASD's loose and disingenuous approach to administrative procedure. Now that the NASD's actions have been drawn out of the shadows, the SEC should send a strong message that unauthorized expansion of SRO jurisdiction will be carefully checked.

In sum, the many factors outlined above call for firm action and strong oversight. The SEC should ***affirmatively reject*** the NASD's petition for rule approval. The NASD's previous administrative actions have generated significant dislocation and market disruption, and have generated a variety of anti-competitive consequences. In fulfillment of its Congressionally mandated duty to carefully evaluate the competitive impairment of proposed SRO rules, the SEC must deny the petition for rule approval filed by the NASD.

Are end-users adequately protected? The answer to that question is unequivocally affirmative as demonstrated by the table of regulatory comparison and by the absence of any demonstrated abuse. Perhaps another way to express the concern would be: would the NASD's proposed rule initiative

impair the interests of consumers and the marketplace? The answer to that question is also unequivocally affirmative. There will be less competition, fewer choices, and greater costs in the distribution of variable contracts to qualified plans by salespersons who are NASD registered representatives, under the NASD's proposed rule changes. The NASD's one sentence assertion that it "does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act" is self-serving, and undocumented by any thoughtful discussion..

We also respectfully recommend that the SEC order the NASD to rescind NTM 97-27 and issue an interpretative position stating that the amendments in Notice to Members 96-66 do not apply to the variable contracts distributed to qualified plans (as referenced in Section 3(a)(12)(A)(iv) of the Securities Exchange Act of 1934). This solution appropriately avoids unnecessary regulatory burdens, and fulfills the intent of Congress in the Government Securities Act Amendments of 1991.

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

Sincerely,

Carl B. Wilkerson

TABLE OF REGULATORY COMPARISONS	
NASD PROVISION	ERISA PROVISION
Institutional Suitability: Established in NASD Notices to Members 96-66 and 97-27.	! The fundamental structure of ERISA and state fiduciary laws place the responsibility for the investment of retirement plan assets on plan fiduciaries, who select and monitor institutions managing plan assets and, with respect to 401(k) plans, also assure participant access to a prudent and diverse range of investments for individual accounts. ! Failure to fulfill these obligations in a prudent manner and solely in the interests of plan participants and beneficiaries subjects the fiduciary to ERISA's enforcement regime. ! Under ERISA, a participant, beneficiary or the Secretary of Labor can bring a civil action against the fiduciary who breached his or her duties. ! The fiduciary is personally liable to make good to the plan any losses resulting from the breach and to restore to the plan any profits that inured to the fiduciary. ! The fiduciary is also subject to other equitable or remedial relief as a court may deem appropriate.

TABLE OF REGULATORY COMPARISONS	
Suitability	! ERISA requires that a fiduciary act prudently and solely in the interest of and for the exclusive benefit of plan participants and beneficiaries. ! ERISA requires that plan assets be adequately diversified. *See*, ERISA at Sections 404(a), 404(a)(1)(B), and 404(a)(1)(C) (1996). ! Unlike other suitability standards that are measured only at the time of purchase, ERISA requires plan sponsors to continually monitor the appropriateness of qualified plan funding vehicles.
Churning	! ERISA specifically prohibits a fiduciary from dealing with assets of a plan in his/her own interest or for his/her own account. [ERISA Section 406(b)(1).]
Statutory Disqualification Provisions	! ERISA prevents any person who has been convicted of certain crimes from serving: as a plan administrator, fiduciary, trustee, custodian or representative in any capacity of any employee benefit plan; as a consultant or advisor to any employee benefit plan; or, in any capacity that involves decision making authority or custody or control of plan assets. [ERISA Section 411.]

TABLE OF REGULATORY COMPARISONS	
NASD authority to conduct inspections and compel production of records.	! ERISA grants the Labor Department the power, in order to determine whether any person has violated or is about to violate any provision of ERISA or any regulation thereunder, to conduct an investigation, and to require the submission of reports, books, and records, and the filing of data in support of any information required to be filed with the Labor Department. ! The Labor Department has the authority to enter business places, inspect books and records, and question persons to enable the Department to determine the facts relative to such investigation. [ERISA Section 504(a).]

TABLE OF REGULATORY COMPARISONS	
Recordkeeping	! ERISA requires extensive recordkeeping, and mandates that certain plan administrators must furnish to participants an individual statement containing information about each participant's benefits. [ERISA Section 105.] ! Section 103 of ERISA requires plan administrators to engage an independent qualified public accountant to conduct such an examination of a financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. This requirement applies to plans covering 100 or more participants, and also mandates that the accountant shall conduct such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant.

TABLE OF REGULATORY COMPARISONS	
Disclosure	! ERISA requires each administrator of a pension plan to furnish to any plan participant or beneficiary who so requests in writing, a statement indicating, on the basis of the latest available information, the total benefits accrued and the nonforfeitable pension benefits which have accrued or the earliest date on which such benefits will become nonforfeitable.
Communications with the Public: NASD Conduct Rule 2110	NAIC Model Unfair Trade Practices Act, which exists in virtually every state. < Section 4(A) involves misrepresentations and false advertising of insurance policies, and identifies unfair trade practices to include any estimate, illustration, circular or statement, sales misrepresentation, omission or comparison that misrepresents the benefits, advantages, conditions or terms of any policy, among other things. < Section 4(A) involves misrepresentations and false advertising of insurance policies, and identifies unfair trade practices to include any estimate, illustration, circular or statement, sales misrepresentation, omission or comparison that misrepresents the benefits, advantages, conditions or terms of any policy, among other things.

TABLE OF REGULATORY COMPARISONS	
Books and Records Requirements: NASD Conduct Rule 3110	NAIC Model Unfair Trade Practices Act, which exists in virtually every state. < Section 4(J) involves the failure to maintain marketing and performance records, and defines as an unfair trade practice the failure of an insurer to maintain its books, records, documents, and other business records in such an order that data regarding complaints, claims, reading, underwriting and marketing are accessible and retrievable for examination by the insurance commissioner. < Data for at least the current calender year in the two preceding years must be maintained under this standard.
Customer Complaints: NASD Conduct Rule 3110 (d) and (e).	NAIC Model Unfair Trade Practices Act, which exists in virtually every state. < Section 4(K) defines the failure of any insurer to maintain a complete record of all the complaints it received since the date of its last market conduct examination to be an unfair trade practice. < The records of complaints must indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint and the time it took to process each. < For purposes of this subsection, the term "complaint" means any written communication primarily expressing a grievance.

TABLE OF REGULATORY COMPARISONS	
NASD Inspection Authority	NAIC Model Unfair Trade Practices Act, which exists in virtually every state. < Section 7 of the Unfair Trade Practices Act gives insurance commissioners extensive authority to initiate hearings concerning unfair trade practices, to compel witnesses, appearances, production of books, and service of process. < Section 7 sets forth detailed administrative and procedural practices, in order to assure due process and quasi-judicial formality
NASD Enforcement Authority	NAIC Model Unfair Trade Practices Act, which exists in virtually every state. < Section 8 of the Unfair Trade Practices statute authorizes insurance commissioners finding insurers guilty of unfair trade practices to issue written findings and enforcement orders requiring the insurer to cease and desist from engaging in the act or practice. [*See,* Section 6, Power of Commissioner, Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-9(1993).]

TABLE OF REGULATORY COMPARISONS	
NASD Authority to Sanction, Revoke Licenses, and Impose Penalties.	NAIC Model Unfair Trade Practices Act, which exists in virtually every state.
	< The insurance commissioner also has the discretionary authority to suspend and revoke the insurer's license if the insurer knew or reasonably should have known that its conduct violated the Unfair Trade Practices Act, and to order penalties of $1000 for each violation up to an aggregate penalty of $100,000, unless the violation was committed flagrantly in conscious disregard of the act, in which case the penalty may be up to $25,000 for each violation to an aggregate total penalty of $250,000. < A similar monetary violation may be imposed under Section 11 for violations of cease and desist orders. The act also provides for judicial review of insurance commissioner orders and authorizes immunity from prosecution for witnesses who attend, testify or produce books, records or other paper correspondence.