NAVA

NATIONAL ASSOCIATION FOR VARIABLE ANNUITIES

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February 3, 2004

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

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OFFICE OF THE SECRETARY

RE: File No. S7-26-03

Dear Mr. Katz:

On December 11, 2003, the Securities and Exchange Commission (the "Commission") proposed amendments to Form N-1A to require open-end management investment companies ("funds") to make certain disclosures in their prospectuses with respect to the frequent purchase and redemption of fund shares, fair value pricing and the disclosure of their portfolio securities. Proposed amendments to Forms N-3, N-4 and N-6 would require similar prospectus disclosures for insurance company separate accounts issuing variable annuity and variable life insurance contracts. [1]

This letter of comment on the proposed amendments is respectfully submitted by the National Association for Variable Annuities ("NAVA").[2]

The proposed form amendments would require detailed disclosure in the prospectuses of insurance company separate accounts that issue variable annuity and variable life insurance contracts regarding the risks of frequent transfers of contract value among sub-accounts, and the separate accounts' policies and procedures with respect to such frequent transfers.

NAVA and its members support the Commission's efforts to protect fund investors and to combat market timing abuses that have reportedly occurred at some mutual fund companies and brokerage firms. We appreciate the opportunity to offer the following comments on the proposed amendments in so far as they would apply to insurance company separate accounts.

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[1] Release No. IC-26287 (December 11, 2003) (the "proposing release"). Throughout this comment letter, proposing release page number references are to the proposing release as issued by the Commission.

[2] NAVA is a not-for-profit organization dedicated to the growth and understanding of annuity and variable life insurance products. NAVA represents all segments of the annuity and variable life industry with over 350 member organizations, including insurance companies, banks, investment management firms, distribution firms, and industry service providers.

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Differences between Insurance Company Separate Accounts and Mutual Funds

With relatively minor modifications, the proposal treats mutual funds and insurance company separate accounts that issue variable insurance contracts in the same manner. There are, however, significant differences between the two which create some unique administrative and operational challenges for insurance companies attempting to comply with the proposed disclosures.

When a mutual fund modifies a policy or procedure, it may do so unilaterally after its board of directors has approved it. Following the board's approval, the modification is simply communicated to existing shareholders and implemented.

In contrast, the relationship between the insurance company and its contractowners is dictated by an insurance contract which is governed under the state insurance laws of the 50 states. As a result, contract rights created by the insurance contract cannot be unilaterally revoked or modified by the insurance company. To change transfer rights in existing contracts would require, at the very least, the filing of amendments to the contracts with every state, with no guarantee of state approval of amendments that would abrogate existing contract rights. In fact, several of our members have informed us that they have discussed these types of changes with various state insurance departments and have been told that any endorsement modifying existing contract rights will not be approved by the departments. Attempts to modify or restrict transfer rights of inforce contracts could also subject insurance companies to litigation by contractowners whose rights have been curtailed.

Many insurance companies have substantial blocks of inforce variable contracts that grant broad rights to make transfers among sub-accounts. Any rulemaking by the Commission must take into consideration the limitations that state contract law places on the insurance company's ability to implement new market timing restrictions on these contracts.

Specificity of Disclosures

The amendments to Form N-1A would require funds to describe with specificity the restrictions they place on frequent purchases and redemptions and the circumstances and arrangements under which the restrictions are not imposed. A similar requirement would be placed on insurance company separate accounts through amendments to Forms N-3, N-4, and N-6.

With respect to insurance company separate accounts, the proposal would require that the policies and procedures of the Registrant or depositor for deterring frequent transfers of contract value among sub-accounts, including any restrictions imposed to prevent or minimize frequent transfers, be described with specificity. The following restrictions, if applicable, must be described:

1. restrictions on the volume or number of transfers that may be made within a given time period;

2. any transfer fee;

3. any costs or administrative or other fees or charges that are imposed on persons deemed to be engaging in frequent transfers of contract value among sub-accounts;

4. any minimum holding period that is imposed before a transfer may be made from a sub-account into another sub-account;

5. any restrictions imposed on transfer requests submitted by overnight delivery, electronically, or via facsimile or telephone; and

6. any right to reject, limit, delay, or impose other conditions on transfers or to terminate or otherwise limit contracts based on a history of frequent transfers among sub-accounts.

The proposing release states that these specific disclosure requirements would enable investors to better assess a mutual fund's [or separate account's] risks, policies, and procedures in this area, and to determine if the policies and procedures are in line with their expectations.[3] While we agree that it is appropriate to provide information to investors that will allow them to evaluate an issuer's policies and procedures, we are concerned that the specificity requirements, as proposed, will not further this goal and may, in fact, hinder companies' ability to curb market timing activities.

We believe that requiring such specificity in the disclosures could have the effect of facilitating market timing by providing timers with a road map showing how to get around the restrictions. For example, if a prospectus disclosed that transfers of contract value between sub-accounts exceeding $500,000 would be disallowed as an attempt to market time, a timer could simply limit the transfer to $499,999. We also believe that requiring the level of specificity as currently proposed will not give insurance companies the flexibility necessary to respond to emerging tactics by market timers. Instead, insurers' will be required to continually supplement their prospectuses to reflect these changes to their policies and procedures. We believe that such requirement will have a chilling effect on insurers' willingness to continuously make modifications. Also, contractowners may be more confused than informed by these numerous supplements.

Additionally, as stated above, some older variable insurance contracts contain broad transfer rights. Requiring these contracts to specifically disclose that they have few restrictions against market timing may have the effect of educating existing

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[3] See proposing release at 6.

contractowners of the market timing opportunities they present and, thus, encourage more, rather than less, market timing activity within them.

Many variable contracts offer a number of investment options. Many of these investment options are offered by fund complexes unaffiliated with the insurance company. In response to the Commission's initiatives, each of these fund complexes will be developing policies and procedures regarding market timing. Insurance companies and the fund complexes will be forced to work together to develop workable policies and procedures. Many of these dedicated insurance funds have a number of participating insurance companies. As these various enterprises work together, it is more than likely that these policies and procedures will continuously evolve. Insurers and the dedicated insurance funds will each be developing standards for determining when someone has engaged in frequent purchase and redemption activities. More than likely, these standards will not be consistent from one organization to another. The specificity that is required by the proposed rule can only be met by the registrant.

Because these dedicated insurance funds offer their shares through multiple insurance companies, and these insurance companies often offer multiple dedicated insurance funds managed by unaffiliated managers, we believe that a more general disclosure may in these circumstances be more meaningful to the contractowners in helping them determine if the policies and procedures are in line with their expectations. More general disclosure will also promote coordination of the policies, procedures and restrictions of the separate account with those of its underlying funds. We are concerned that the specificity required by the rule will not give the parties the opportunity to continuously work towards workable and effective policies and procedures.

We are also concerned that requiring specificity in the disclosures will result in substantially more voluminous prospectuses, along with the potential to cause confusion to investors. Additionally, the specificity requirement may mean that insurance company separate accounts would have to describe the policies, procedures and restrictions of its underlying funds as well, adding further to the volume of prospectus disclosures.

NAVA and its members recommend that the specificity requirement in the proposal be eliminated and that the form amendments require that the separate account's policies, procedures and restrictions with respect to frequent transfers of contract value among sub-accounts be described generally, with separate accounts having the option of including more specific descriptions if they so desire.

Description of Risks

The proposed amendments to Forms N-3, N-4, and N-6 would require disclosure of the risks that frequent transfers of contract value among sub-accounts may present not only for other contractowners, but also for other persons who have material rights under the variable contract, including, in the case of Forms N-3 and N-4, participants, annuitants, and beneficiaries, and in the case of Form N-6, the insured or beneficiary.

We request clarification of the requirement that the risks for persons besides other contractowners be described. We do not see how the risks from frequent transfers would be different for such other persons than for other contractowners and believe that a detailed discussion of annuitants, beneficiaries, etc. will tend to detract attention from more relevant disclosures.

Description of Arrangements to Permit Frequent Transfers

The proposed amendments would also require a detailed description of any arrangements with any person to permit frequent transfers of contact value among sub-accounts, including the identity of the persons permitted to engage in frequent transfers pursuant to such arrangements. Over the years insurance companies have added many more investment options to their variable contracts. Because of this broad range of investment options, purchasers and contractowners have turned to investment professionals to assist them in the initial selection of sub-accounts and the continued monitoring of the selections. A number of insurance companies permit such professionals to actively assist these contractowners but do not endorse or promote their services. Insurance companies often require these investment professionals to enter into an agreement with the insurance company because they are frequently trading on behalf of multiple contractowners representing a significant amount of assets. These agreements set out the administrative guidelines under which the professional must conduct its services to the contractowner. These agreements are not intended to promote market timing but rather to allow the insurance company to identify and monitor the activities of these professionals and to establish limits on their activities. Our members believe that requiring such detailed disclosure raises privacy and confidentiality issues.

In addition, some insurers have entered into settlement agreements to settle lawsuits and claims brought by contractowners asserting that they had contract rights that permited them to make frequent transfers. The terms of these settlements commonly specify that they be kept confidential. The final form amendments should not require disclosure of such settlements.

Location of the Proposed Disclosures

The Commission has requested comment as to whether the prospectus is the appropriate location for each of the proposed disclosures. Market timing activities and the responses of funds and insurance company separate accounts to curtail them have evolved and changed over time. We are concerned that requiring market timing policies, procedures and restrictions to be described with specificity in the prospectus could inhibit the ability of funds and insurance company separate accounts to respond quickly to the actions of market timers. If the specificity requirement is adopted, companies would have to issue supplemental prospectuses every time they wanted to modify or impose new restrictions to address new market timing activities.

Compliance Date

The proposing release states that if the proposed disclosure requirements are adopted, the Commission expects to require all new registration statements and all post-effective amendments to effective registration statements filed on or after the effective date of the amendments to comply with the proposed amendments.[4] Insurance company separate accounts will have to perform a number of time consuming tasks in order to implement any required disclosures, including state filings of contract amendments, significant system modifications, education and training of sales representatives, and coordination of relationships with underlying funds if the disclosures must be made with specificity. The effective date chosen for the proposed amendments must provide sufficient time for these and other tasks to be performed.

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Again, we appreciate the opportunity to comment. If we can answer any questions or be of further assistance, please contact me at (703) 707-8830, extension 20, or Judith Hasenauer at (954) 545-9633. Ms. Hasenauer chairs NAVA's Regulatory Affairs Committee.

Sincerely,

Michael P. DeGeorge
General Counsel

[4] See proposing release at 16.