CARL WILKERSON
CHIEF COUNSEL, SECURITIES & LITIGATION
carlwilkerson@acli.com

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Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
Room 6184, Stop 6-9
450 Fifth Street, N.W.
Washington, D.C. 20549

By e-mail

RE: Release No. 34-48390; File No. SR-NASD-2002-131; *Proposed NASD Telemarketing Rule Amendments to Implement the National Do-Not-Call Registry*

Dear Mr. Katz:

The American Council of Life Insurers respectfully requests that the comment period on Release No. 34-48298 be extended for 30 days to provide an opportunity for careful analysis and constructive comment on the NASD proposal. The Release invited comment on proposed changes to NASD telemarketing rules, and appeared in Federal Register Vol. 68, No. 166 at 51613 on August 27, 2003. We also offer substantive comment on several aspects of the NASD proposal.

The American Council of Life Insurers ("Council") is a national trade association with 399 members representing 72 percent of all United States life insurance companies. Many of our member companies offer and distribute variable annuities, variable life insurance and mutual funds directly or through affiliated and independent broker/dealers. Our member companies and their broker/dealer affiliates have concerns with the NASD's proposed telemarketing rule amendments. The initiative would have a significant, unique impact on our industry and the products they manufacture.

We have actively participated in numerous NASD rulemaking initiatives. SEC oversight of SRO rule proposals ensures balanced regulations in the public interest, and provides an important protection against SRO rules that may impede competition. The full execution of SEC oversight and public comment is fundamental to sound rulemaking.

Background

Earlier this year, both the Federal Trade Commission ("FTC") and the Federal Communications Commission ("FCC") established requirements for sellers and telemarketers to participate in a national do-not-call registry. Beginning in June 2003, consumers have been able to enter their home telephone numbers into the national do-not-call registry, which is maintained by the FTC. Under rules of the FTC and FCC, sellers and telemarketers generally are prohibited from making telephone solicitations to consumers whose numbers are listed in the national do-not-call registry. According to the release, the FCC's rules are directly applicable to broker-dealers.

On July 2, 2003, the SEC requested that NASD amend its telemarketing rules to include a requirement for its members to participate in the national do-not-call registry. Thirty-three days later, NASD filed with the SEC proposed rule amendments to NASD Rules 2211 and 3110(g) to implement the national do-not-call registry, which were published in the Federal Register on August 27, 2003. The release set a 21-day comment deadline ending today, September 17, 2003.

The NASD originally developed Rules 2211 and 3110(g) in response to FCC and FTC requirements for firms to maintain do-not-call lists and to limit the hours of telephone solicitations.[1] NASD Rule 3110(g)(1) currently requires firms to maintain firm-specific do-not-call lists. In an effort to consolidate and clarify NASD's telemarketing rules, NASD is proposing to combine Rule 3110(g)(1) with its main telemarketing rule, Rule 2211. The remaining sections of Rule 3110 are substantively unchanged.

The release states that because broker-dealers and banks are subject to the FCC's jurisdiction, the NASD modeled its proposed rule changes after the FCC format, *with minor modifications tailoring the rules to broker-dealers and the securities industry*. The proposed rule amendments need further tailoring to fully accommodate all broker-dealers subject to the NASD's jurisdiction.

Issues Raised by the Proposal

Not all NASD members are full-service broker-dealers. Many NASD members are limited purpose broker-dealers affiliated with life insurance companies, and principally distribute variable life insurance and variable annuities. As a matter of perspective, over 50% of the NASD's 664,798 registered representatives work for broker-dealers affiliated with life insurance companies.

Variable life insurance and variable annuities are hybrid instruments with important securities *and* insurance characteristics. Several aspects of the NASD's proposal do not properly accommodate the insurance characteristics of variable contracts and the special business relationships that flow from them.

The NASD proposal provides an exception allowing broker-dealers to make telephone solicitations to individuals with whom the broker-dealer has an established business relationship. This sensible exception allows broker-dealers to communicate with securities customers while continuing to conduct business with them.

Proposed Section (g)(1) of Rule 2211 provides that an established business relationship exists between a broker-dealer and a customer if:

> (i) the person has made a financial transaction with the member within the previous 18 months immediately preceding the date of the telemarketing call; or
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> (ii) the person has contacted the member to inquire about a product or service offered by the member within the previous three months immediately preceding the date of the

[1] See 60 FR 31527 (June 15, 1995) (approving NASD rule requiring members to maintain firm specific do-not-call lists); 61 FR 65625 (Dec. 13, 1996) (approving NASD rule creating telemarketing time-of-day restrictions and disclosure provisions).

telemarketing call.

In explaining the scope of this exception, the release states:

> for purposes of paragraph (g)(1)(A)(i), NASD proposes interpreting the term "financial transaction" to mean that a person has *effected a securities transaction or deposited funds* or securities with the member. NASD does not believe that under the FCC's or FTC's definitions of established business relationship, the receipt of interest or dividends would constitute a financial transaction. We note that this is a distinction from current Rule 2211(c)(2), under which a person could be an existing customer solely on the basis of interest or dividend income. However, because members are subject to FCC rules, we have sought to harmonize NASD standards with those of the FCC. We also believe that consumers generally would not view receiving interest or dividends as sufficient to overcome their expectation that entering their telephone number in the national do-not-call registry will curtail telephone solicitations.[2] [Emphasis added].

The NASD's explanation of the *established business relationship* exception and definition does not properly accommodate the interests of broker-dealers distributing variable life insurance and variable annuities. Variable life insurance and variable annuities are long-term financial products used in estate, retirement, tax, and financial planning. Premiums during the accumulation periods can be scheduled, flexible (allowing the customer to increase, decrease, or skip payments), or single payment. Through these payment mechanics, the life insurance company and its agents conduct a continuous, long-term business relationship with their customers.

Compared to situations where a customer has effected a securities transaction or deposited funds as a completed action, life insurance and annuity contracts are long-term accumulation products necessitating long-term business relationships with customers. For example, under flexible premium variable life insurance contracts, customers may increase, decrease, or skip premium payments. The life insurer must remain in a continuous business relationship to process premium payments, and to promptly inform customers if decreased or skipped premium payments would risk termination of the contract and impair essential death benefit protection. Likewise, life insurers and their agents (broker-dealers) must quickly communicate with customers if the corridor between the death benefit and the accumulation unit values would exceed permitted IRS standards due to the increased premium payments.

Because of the long-term purposes of insurance and annuity contracts, life insurers must have the ability to communicate with customers, if changes in laws or regulations impair the customer's status or estate, retirement, tax or financial planning objectives. Changes in the law adverse to contract owners' goals can be rectified by altering or supplementing the original purchase. For example, provisions in the Sarbanes-Oxley Act created significant interpretive and status questions for customers using life insurance contracts in "split-dollar" arrangements. To prevent lapsation for non-payment of premiums while the interpretive issues are clarified and to avoid a gap in death benefit protection, insurers were able to promptly call contract owners to suggest alternative approaches preserving the original goals of the customer. Parallel situations have occurred following estate, pension and tax law changes.

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[2] *See* release at 51616.

Over the course of long-term life and annuity contracts, customers can experience a number of significant life events, such as births, death, martial changes, retirement, or mortgages. These changes warrant a call from life insurers to assure that the existing contract continues to fulfill the customer's needs. Some contracts have optional provisions and riders that need to be affirmatively exercised to effectuate the contract owner's goals as these events occur.

To deny life insurers the ability to call contract owners to prevent adverse consequences or to attain long-term financial objective is not in the public interest. Indeed, it can effectively handcuff life insurers from serving and protecting the best interest of their customers. This aspect of the rule amendment is illogical and contrary to the public interest.

In explaining the scope of established business relationship exception, the release states that the receipt of interest or dividends would not constitute a financial transaction under Section (g)(1)(A)(i) of Rule 2211. This statement does not apply well to insurance and annuity contracts that effectively reduce premiums through the payment of dividends to mutual policyholders, or increase account values through excess interest payments by insurers to customers in some guaranteed investment contracts registered under the Securities Act of 1933. The release's interpretive embellishment is misplaced and unnecessary with respect to insurance and annuity contracts. Furthermore, the release's assertion that the NASD's position on interest and dividend payments parallels the FCC rules is not supported by either the FCC rule or release.

These considerations are unique to life insurance and annuity contracts, which are defined as *periodic payment plans* under the Investment Company Act of 1940. They are not a single purchase event, but a long-term relationship between the contract owner and the life insurer. Unlike publicly traded securities or even mutual funds, variable annuities and variable life insurance are contracts subject to, and approved under, state insurance laws that impose on-going, continuous rights and obligations on the customer and the life insurer. The core, long-term accumulation features of variable contracts are uniquely distinguishable and different from effecting a securities transaction or depositing funds at a single point in time.

While the three-month and 18 month triggers in the proposal's definition of *established business relationship* may make sense in securities and banking transactions, they apply poorly to the insurance characteristics of variable contracts. The application of these time limits to on going, long-term life and annuity contracts would create profound burdens for life insurers and their customers.

The release states that the NASD amendments are modeled after the FCC approach, with modifications tailored to broker-dealers and the securities industry. It is critical that the NASD tailor the rules to accommodate the needs of *all* broker-dealers, not just full-service broker dealers. The negative competitive impact caused by the rule and statements in the release is unwarranted. The SEC has an important responsibility to assure that self-regulatory rules do not have an anti-competitive impact contrary to the public interest.

As explained above, the proposed amendment has a disproportionate burden on broker-dealers affiliated with life insurers, and the products they principally distribute. Moreover, application of the proposal could cause significant harm to insurance and annuity contract owners, if life insurers could not call them to highlight alternatives preserving their original objectives in light of changes in the law enacted after the initiation of the long-term contract.

Solution

The final rule and release can remedy the problems discussed above. The release and the rule should state that variable life insurance and variable annuities are long-term contracts fulfilling the definition of established business relationship while the contract is in effect. The release should indicate that the payment of interest and dividends in connection with insurance and annuity contracts is a financial transaction for purposes of Rule 2211.

These recommended changes will properly accommodate the unique insurance features of variable life insurance and variable annuities, and will ameliorate the anti-competitive burdens of the proposal on the life insurance industry. Moreover, the suggested solution will serve the best interests of the public allowing customers to preserve their long-term objectives in acquiring variable life insurance and variable annuity contracts.

Competitive Balance Considerations

There are several important guideposts to 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. 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.[3]

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.[4] Measured against these statutory benchmarks, the NASD's rule amendments need to be carefully evaluated to assure that broker-dealers affiliated with life insurers are not competitively disadvantaged because the NASD has overlooked the unique insurance characteristics of variable contracts.

Basis for Reasonable Extension of the Comment Period

A 21-day comment period is insufficient to address the issues raised in the release. As a practical matter, most observers had fewer than 21 days to digest the proposal following its August 27, 2003 printing date due to time consumed in delivery and dissemination of the Federal Register. Some of the provisions appeared for the first time in the release, and will require substantial time to analyze.

These factors support a reasonable extension to the comment period. Industry groups like our trade association circulate regulatory proposals, elicit membership input, develop a consensus, and

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

[4]*Id*. at 12.

circulate a draft letter of comment before submission. This is a worthwhile but time intensive process that is difficult to execute in 21 days.

The special time burdens confronting regulated industries and large organizations in digesting regulatory proposals were explicitly recognized by the Administrative Conference of the United States in its publication entitled *A Guide to Federal Agency Rulemaking*, which observes:

> The 60-day period established by Executive Order 12044 for significant regulations (and no longer in effect unless adopted by agency rule) is a more reasonable *minimum* time for comment. However a longer time may be required if the agency is seeking information on particular subjects or counter-proposals from regulated industry. *"Interested persons" often are large organizations and they need time to coordinate and approve an organizational response or to authorize expenditure of funds to do the research needed to produce informed comments.*[5]

An extended comment period will not unduly lengthen this regulatory matter, and will foster constructive, thoughtful input on the issues raised by the NASD's proposal. The regulatory process and the public interest will be better served by a deliberative review of the NASD's rule amendments. These regulatory modifications are too important to miss full exposure to public scrutiny.

For these reasons, we respectfully request that the Commission extend the comment period on Release No. 34-48390 for a 30-day period. It would be most constructive to publish notice of a rule extension formally, so that members of the public will not be discouraged from submitting comments after the expiration of the release's 21-day comment period.

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

Sincerely,

Carl B. Wilkerson

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[5] *See, A Guide to Federal Agency Rulemaking* (1983) at 124.