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September 30, 2008

VIA E-MAIL

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1500

**Re: Regulatory Notice 08-39:
Request for Comments on Proposed New Rules Governing Communications
About Variable Insurance Products**

Dear Ms. Asquith:

The Investment Company Institute¹ supports FINRA's proposed rules governing communications about variable insurance products (the "Proposed Rules").² The Institute believes that the Proposed Rules would provide clarity by codifying and consolidating certain FINRA positions regarding variable insurance product communications. We also believe their implementation would advance consistent disclosure to variable contract owners, provide an accurate basis for comparing different products, and assist in portraying a balanced picture of variable insurance products overall.

The Institute's comments in this letter focus primarily on the provisions of the Proposed Rules that would impact communications relating to the mutual funds that are available as underlying

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs"). The Institute seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of the Institute manage total assets of \$12.14 trillion and serve almost 90 million shareholders.

² FINRA Regulatory Notice 08-39 (July 2008) ("Notice 08-39").

investment options in variable contracts (referred to generally as “underlying funds”).³ In addition, we are providing comments on several provisions of the Proposed Rules that would generally impact communications relating to variable contracts rather than underlying funds, but which underlying funds nonetheless have an interest in ensuring are fair and balanced.⁴

I. Pre-Dated Performance

The Institute supports proposed paragraph (f)(3) of new IM-2210-2, which would permit, but not require, the presentation of performance of an investment option that occurred prior to availability of that option through a variable insurance contract (“Pre-Dated Performance”). We recognize that “standard” performance relating to an investment option offered in a variable contract should begin at the time the investment option is first offered through the separate account. We believe, however, that investors also want to be able to assess the performance of the underlying fund from its inception in the same way they would if the underlying fund were offered to retail investors. Therefore, we agree that FINRA’s current policy – to permit Pre-Dated Performance as non-standard performance – should be codified through the adoption of proposed IM-2210-2(f)(3).⁵

As proposed, use of Pre-Dated Performance also would be subject to the following five conditions:

- (1) The presentation must meet the requirements of (f)(1)⁶ and (f)(2)⁷;

³ For tax reasons, the underlying funds that are available through registered insurance company separate accounts generally are not permitted to be offered to the general public. Shares of certain insurance funds may also be permitted to be offered to certain types of tax-qualified retirement plans, but unless otherwise noted the Institute’s comments do not address the potential impact of the Proposed Rules on sales of fund shares to these plans.

⁴ For ease of reference, this comment letter sometimes refers to insurance companies as issuers of variable annuity contracts although, under the federal securities laws, insurance company separate accounts are the primary issuers of variable annuity contracts, with the insurer as a separate entity co-issuing a contract.

⁵ See page 6 of Notice 08-39. See also “Variable Annuity Performance,” NASD Regulatory and Compliance Alert (Summer 2002).

⁶ Paragraph (f)(1) would require any presentation of historical performance to comply with Rule 482 under the Securities Act of 1933 (the “1933 Act”) or Rule 34b-1 under the Investment Company Act of 1940 (the “1940 Act”), as applicable.

⁷ As discussed in more detail below, paragraph (f)(2) would require the deduction of all fees and charges applicable at the investment option level and prominent disclosures urging investors to obtain a personalized hypothetical illustration.

- (2) Pre-dated performance for variable annuities must either be net of maximum guaranteed charges or accompanied by performance that is net of such charges;
- (3) There may not be any significant change to the investment objectives, strategies or policies of the investment option during the period for which performance is shown;
- (4) The performance may not reflect the performance of a fund that is not available as an investment option through the separate account; and
- (5) The period during which the performance occurred must be identified and a disclosure must be made that indicates that the performance pre-dates inclusion of the underlying fund in the separate account.

Although we support the use of Pre-Dated Performance, we request certain clarifications and revisions regarding these conditions that would be imposed upon the use of such performance.

A. Requirement to Accompany Pre-Dated Performance with Certain Standard Performance

Paragraph (f)(3)(A) of proposed IM-2210-2 requires Pre-Dated Performance to comply with paragraphs (f)(1) and (f)(2), and in particular, if the investment option has been available through the separate account for more than one year, the performance must be accompanied by performance of the investment option for the period commencing on the date the fund became available through the separate account. Looking first at how this condition applies to Pre-Dated Performance, paragraph (f)(1) requires variable annuity performance presentations generally to comply with Rule 482. Rule 482 specifies certain “standard” variable annuity performance that must be included with any “non-standard” performance. We presume that the additional investment option performance required by the “in particular” clause of proposed paragraph (f)(3)(A) is the standardized performance required by Rule 482. We further presume that this “standardized performance” is the investment option’s performance adjusted for contract-level fees and charges, because this is the standardized performance required by Rule 482 for variable annuities. It is also what we understand FINRA now requires in the context of Pre-Dated Performance.

However, some of our members have expressed concern that the “in particular” clause could be read to require Pre-Dated Performance to be accompanied by non-charge-adjusted investment option performance from the availability date. We seek clarification that this was not FINRA’s intention. If paragraph (f)(3)(A) is, in fact, intended to require communications regarding variable annuities presenting Pre-Dated Performance to include unadjusted investment option performance, the Institute would strongly oppose that requirement. This is because it would mandate a new type of performance that has not been included in pre-dated performance presentations, and it would clutter communications with unnecessary information.

With respect to communications regarding variable life insurance policies, we request confirmation that Pre-Dated Performance presented in such communications would not be required to be accompanied by any form of investment option performance for the period commencing on the separate account “availability” date. Such information is not currently required because Rule 482’s “standard” performance requirements do not apply to variable life performance presentations, and we do not believe such information is necessary.

B. Deduction of Maximum Guaranteed Charges

Pre-Dated Performance for variable annuities would be required to either be net of “maximum guaranteed charges” or accompanied by performance that is net of such charges.⁸ Maximum guaranteed charges are defined as the maximum recurring and non-recurring charges under a contract, but would not include charges for optional riders. The Institute believes that the exclusion of optional rider charges is appropriate because Pre-Dated Performance should reflect underlying performance without the impact of optional rider charges that only some contract owners may require. We do not believe it is appropriate, however, to require the maximum charges possible under a contract to be deducted in calculating Pre-Dated Performance in situations where the current charges are lower. We believe this modification would most accurately reflect the performance that would have been experienced had the investment option been available under the contract, and would be consistent with FINRA’s current requirements.

C. Availability of Investment Option

Paragraph (f)(3)(d) would prohibit a communication including Pre-Dated Performance from including the performance of a fund that is not available as an investment option through the separate account. We believe that the guidance provided in Notice 08-39 regarding the intent of this provision – that it would not permit the presentation of the performance of a similar “clone” fund – provides useful clarity, and we request that similar guidance be provided in the final rule text as to what types of funds or other accounts could be included in Pre-Dated Performance.

⁸ See proposed IM-2210-2(f)(3)(B) (requirement that Pre-Dated Performance must be net of maximum guaranteed charges) and IM 2210-2(a)(4) (definition of “maximum guaranteed charges”).

D. Significant changes in investment options

We seek clarification with respect to the phrase “significant change” as used in the third condition, which states that there may not be any significant change to the investment objectives, strategies or policies of the investment option during the period for which performance is shown. We believe the phrase is vague and could be interpreted in a manner that is not consistent with applicable guidance from the Securities and Exchange Commission in this regard. Under existing SEC guidance, when there has been a change of investment policy, industry practice generally has been to note that fact in a footnote to performance presentations. We believe that this practice has been adequate to provide investors with an informed basis for decision-making. We would request therefore that the phrase “significant change” be changed to “fundamental change” and that FINRA member firms be permitted to interpret this phrase in conformity with existing SEC guidance. In this regard, the SEC and its staff have expressed the view that an investment company should not be permitted to eliminate poor historical performance simply by altering some aspect of the company’s investment objective.⁹

Finally, we note that the third condition as proposed raises the issue of whether Pre-Dated Performance could be utilized where a variable insurance contract includes an asset allocation program as an investment option. If the asset allocation program were to employ a portfolio that includes an investment option that had undergone a “significant change,” the Proposed Rules appear to suggest that the Pre-Dated Performance for the asset allocation program would be disallowed. The Institute accordingly requests that the phrase “significant change” be replaced, as suggested above, or that FINRA provide guidance as to the meaning of “significant change” in this context.

⁹ *See, e.g.*, Comstock Partners Strategy Fund, Inc. (pub. avail. Apr. 6, 1995) (conversion from a closed-end fund to an open-end fund, by itself, is not such a fundamental change that would justify, under Rule 482(e), the elimination of prior performance); Zweig Series Trust (pub. avail. Jan. 10, 1990) (fund may not exclude performance information when new investment adviser has common officers with prior investment adviser); The Fairmont Fund Trust (pub. avail. Dec. 9, 1988) (fund’s change from a non-diversified, aggressive trading fund to a diversified, balanced fund would not warrant, under Rule 482(e), the exclusion of the fund’s standardized performance information for the period prior to the management change).

II. Multiple Investment Option Performance

The Institute supports the adoption of proposed IM-2210-2(f)(4), which would permit combined historical performance of multiple investment options subject to certain conditions.¹⁰ We believe that combined historical performance would be particularly important to variable contract investors where the contract offers contract purchasers the ability to allocate their purchase payments and contract value in accordance with asset allocation models. Institute members increasingly find that their underlying funds are being used in connection with variable contract asset allocation models, particularly in connection with contracts that offer guaranteed lifetime withdrawal benefits and other living benefits. Insurance companies often require contract owners to allocate their purchase payments and contract value to prescribed asset allocation models consistent with the insurance company's significant undertaking of investment risk in connection with providing those guarantees.

III. Variable Annuity Performance and Variable Life Insurance Policy Performance

The Institute generally supports the Proposed Rules relating to communications of variable annuity historical performance. We believe that requiring compliance with Rule 482 under the 1933 Act and Rule 34b-1 under the 1940 Act, as applicable, will ensure that investors are provided with a fair and balanced presentation of such performance.

We also support the disclosure required by proposed IM-2210-2(f)(2) that explains which policy level fees are, and are not, deducted from variable life historical performance. We believe such disclosure provides investors with a more accurate basis by which to compare underlying fund performance. While we believe that the Proposed Rules with respect to variable life insurance policy performance will be generally beneficial, we would request that FINRA clarify that the Proposed Rules are intended to eliminate the current requirement that variable life insurance policy performance be used only if preceded or accompanied by a statutory prospectus (that is, used only in supplemental sales literature).

¹⁰ The proposed conditions would include: (1) any communication would have to satisfy the other requirements for variable annuities, variable life insurance products and Pre-Dated Performance, as applicable; (2) the communication would have to present the individual performance of each investment option within the combined performance; and (3) the communication would have to disclose the names of the investment options included within the combined performance, the investment percentage allocated to each investment option for the purposes of the combined performance calculation, and a statement that the combined historical performance is hypothetical because it is based on assumed investment allocations.

IV. Illustrations Based on Assumed Rates of Return

The Institute generally supports proposed IM-2210-2(g) regarding assumed-rate illustrations, regardless of whether they employ a single or multiple assumed rate of return, as these provisions codify existing FINRA guidance.¹¹

A. Single Assumed Rates of Return

We note that proposed IM-2210-2(g) would permit, but not require, FINRA member firms to show investment results based on assumed positive gross annual rates of return up to ten percent, so long as the results reflect the deduction of maximum guaranteed charges. Currently, FINRA guidance permits illustrations with rates of return up to twelve percent as long as such illustrations also show a zero percent assumed rate of return.¹² While we recognize that, in the current market, ten percent may be an appropriate maximum assumed rate, we believe that the maximum assumed rate of return should be subject to prevailing market conditions. As noted, FINRA had previously concluded that, under then-prevailing market conditions, it was not inappropriate to reflect an assumed rate of return of up to twelve percent.¹³ Accordingly, we support the standardization in the proposal permitting use of an assumed rate of return up to ten percent, but we recommend that FINRA continue to monitor prevailing market conditions on a regular basis to determine if additional changes to the maximum permitted assumed rate of return may be appropriate.

¹¹ All illustrations to use assumed rates of return would be required to: (1) show investment returns that are based on an assumed gross annual rate of return of zero and reflect the deduction of the maximum guaranteed charges; (2) depict, at a minimum, year-by-year account values; (3) clearly label and define all values and include the gross and net rates of return depicted; (4) reflect an arithmetic average of all investment option expenses or a weighted average of investment option expenses; and (5) explain that its purpose is to show how the performance of the investment accounts could affect the policy cash value and death benefit, and that the illustration is hypothetical and does not predict future performance.

¹² See, e.g., "Internal Rates of Return in Variable Life Hypothetical Illustrations," NASD Regulation, Inc., Regulatory & Compliance Alert (Winter 1998).

¹³ Proposed IM-2210-2(g) would also permit the use of an assumed negative gross rate of return in illustrations if the illustration reflects the deduction of maximum guaranteed charges and also shows separate investment results that are based on an assumed positive gross annual rate of return of at least five percent and not more than ten percent. While we understand the utility of this provision, we agree with FINRA that it is not useful to show illustrations where the annual rate of return is constantly negative without balancing it with an illustration showing positive rate of return. However, in this context, we would reiterate that we believe the maximum rate of return does not necessarily need to be codified as ten percent.

In addition, we request confirmation of our understanding that illustrations may demonstrate the deduction of current charges in addition to maximum guaranteed charges. While we understand the utility of reflecting the deduction of maximum guaranteed charges, we also believe investors are likely to be interested in the impact of actual fees being charged.

B. Multiple Assumed Rates of Return

The Institute generally supports proposed IM-2210-2(g) as it relates to multiple assumed rates of return. We note that it includes, however, a significant departure from existing FINRA guidance. Currently, such varying rate illustrations may be based on any random rate. Under the Proposed Rules, however, any illustrations based on multiple rates of return would have to be based on the actual performance of a broad-based securities market index for the period shown by the illustration. The Institute is concerned that this change from existing guidance could require significant resources to implement. We understand that the use of the actual performance of an index may be useful to investors (and in fact has been requested to be used by some insurance companies in the past). We request, however, that FINRA provide a significant transition period to permit compliance with the new rule.

We note in addition that the term “broad-based securities market index” is not defined in the Proposed Rules, although Notice 08-39 indicates that an index would need to be one that is “used as a basis for comparison in discussions of fund performance in prospectuses for available investment options” and lists the Standard and Poor’s 500 Index as an index that would meet this requirement. We request clarification as to any other limitations with respect to the term “broad-based securities market index” and would find it helpful to have included in commentary to the final rule any specific examples of indices that would not qualify. We also request that FINRA confirm that it would be permissible to use multiple-rate illustrations where the rates are based on blended index performance. For example, such an illustration may be based on a weighted average of a broad-based equity market index and a fixed income market index to simulate the return of a balanced portfolio.

C. Reflecting Fund Expenses in Illustrations

As indicated above, proposed IM-2210-2(g)(7) requires that illustrations included in communications relating to variable products that use assumed rates of return would be required to reflect either an arithmetic average of all investment option expenses or a weighted average of investment option expenses. If a firm chooses to use a weighted average, the illustration would have to identify the investment options being used and the investment amount allocated to each option. If a firm chooses to use illustrations incorporating a weighted average of expenses with multiple customers,

the illustrations would have to reflect the current actual weighted average of investment options held by all investors through the separate account.

FINRA has previously permitted firms to reflect a weighted average of fund level expenses in variable life insurance hypothetical illustrations used with multiple customers only if accompanied or preceded by a prospectus and accompanied by a general illustration reflecting the arithmetic average of underlying fund expenses. The Institute seeks confirmation that, under proposed IM-2210-2(g)(7), these requirements would no longer be imposed.¹⁴

V. Illustrations Based on Historical Performance

The Institute supports proposed IM-2210-2(f)(5), which would permit historical performance illustrations using assumed dollar investment amounts, subject to certain conditions,¹⁵ to the extent that it codifies existing FINRA guidance. Investors faced with making decisions regarding their investments in underlying funds will likely find a demonstration of the impact of fees and charges on an actual – albeit hypothetical – investment to be very useful.

We note, however, that there is no definition of “illustration” generally in the Proposed Rules and are concerned that, without some limitations, the provisions of the Proposed Rules relating to “illustrations,” whether those that use assumed rates of return or historical rates of return, could be read broadly to encompass product explanations that are not intended to be captured. For example, some insurers now routinely include a series of relatively basic “step-by-step” examples of how guaranteed withdrawal benefits work in variable annuity prospectuses.¹⁶ Such examples are now routinely requested by the SEC staff to be included in prospectuses. To the extent similar examples are used by an insurer in sales materials, we do not believe proposed IM-2210-2 should apply. The Institute

¹⁴ See “NASD Reminds Members of Their Responsibilities Regarding Hypothetical Tax-Deferral Illustrations in Variable Annuity Illustrations,” NASD Member Alert (May 10, 2004).

¹⁵ The proposed conditions would require that the illustration must: (1) meet the above-described requirements for variable annuities, variable life insurance products, Pre-Dated Performance and combined performance as applicable; (2) present dollar values net of fees imposed at the investment option level and, for variable annuities, net of maximum guaranteed charges; (3) present year-by-year account values in a tabular or bar-chart format that labels and defines all columns or bars; and (4) explain that it is based on a hypothetical dollar investment and that it is not intended to predict or project future performance.

¹⁶ Further, we note that, in the discussion of the definitions section, Notice 08-39 states that “the definitions section is not intended to define insurance-related terms in other contexts beyond the scope of this rule.” We would request that such a clarifying phrase be included in IM-2210-2 itself as amended, to codify this important limitation.

respectfully requests that clarification be provided specifying the type of illustrations meant to be included.¹⁷

VI. Historical Performance of Selected Investment Options

Proposed IM-2210-2(f)(6) permits presentation of the performance of one or more investment options without presenting the performance of all investment options available through the separate account. We believe that investors want to be able to review historical underlying fund performance, and that the disclosure proposed to accompany such a selective presentation— a statement that the investment options depicted are not the only ones offered within a product— provides appropriate and adequate notice to investors.

VII. Guarantee Claims and Riders

Notice 08-39 indicates that FINRA recognizes the need to communicate the features of variable contract guarantees and riders in advertising and sales material, and it notes that current guidelines only discuss claims about guarantees, rather than riders. The Institute commends FINRA for its efforts to make discussions of riders more uniform and accurate. While the discussions of guarantees and riders do not affect most of our members directly, we would note that any restrictions that negatively impact the sale of variable insurance products would have a bearing on underlying funds.

Proposed IM-2210-2(d) would require that all communications discussing the circumstances under which a guarantee or rider would benefit a customer be “fair and balanced considering the circumstances under which the guarantee or rider will not benefit the customer.” We are concerned that, without further clarification of this provision, firms could be subject to second-guessing regarding their disclosure. Notice 08-39 explains that fulfillment of this requirement would not require exhaustive disclosure of every circumstance in which a rider would not benefit a customer, but the Notice does not delineate the required extent of such disclosure.¹⁸ We believe FINRA should provide additional guidance regarding the scope of the required disclosure under proposed IM-2210-2(d). We

¹⁷ For example, the use of tables illustrating different annuity payout rates should not be subject to IM-2210-2.

¹⁸ Notice 08-39, at page 4.

also recommend that FINRA acknowledge that a reference in sales materials to the specific location of such disclosure in the product prospectus would be sufficient to satisfy the proposed disclosure requirement.¹⁹

The Proposed Rules also state that any discussion of a guarantee must disclose all material applicable limitations or qualifications. We support the requirement that a discussion of benefits be balanced by a corresponding discussion of the potential limitations, but we do not believe it is useful to investors to see an exhaustive list of limitations every time a guarantee is mentioned. The Institute accordingly requests that further guidance be provided as to what is meant by a “discussion” of a guarantee. In our view, for example, a press release or advertisement that simply mentions the existence of a guarantee should not have to contain the additional disclosure of all material limitations or qualifications.

VIII. Product Identification and Liquidity

Proposed paragraphs (b) and (c) of IM-2210-2 would address product identification and liquidity issues raised by variable insurance product communications. Paragraph (b) would require that all communications clearly identify the type of product discussed. Under the Proposed Rules, communications may not represent or imply that variable insurance products are mutual funds. The Institute generally supports this proposed prohibition, but requests clarification that communications may continue to state that the product invests in mutual funds. We believe that it is useful to inform customers that a mutual fund underlies the product, so that customers are provided with an accurate metric by which to understand the product they are purchasing.

IX. Tax-Deferred Illustrations

The Proposed Rules would consolidate previously issued FINRA guidance by adding new language to IM-2210-1 concerning comparative illustrations of the mathematical principle of tax-deferred versus taxable compounding contained in communications. These standards would apply to any illustration of tax-deferred versus taxable compounding regardless of whether it appears in a communication promoting variable insurance products or some other communication.

¹⁹ Proposed IM-2210-2 would include a separate paragraph of defined terms, including “maximum guaranteed charges” and “rider.” We have discussed our concerns with respect to the definition of “maximum guaranteed charges” above. We believe that a more precise definition of “rider” would be useful and propose that the definition of “rider” be amended to clarify that it is an optional benefit outside of a contract rather than a part of the contract itself.

Communications relating to comparative illustrations would be required to meet certain requirements, including reflecting an actual state income tax rate if used only with investors in that state.²⁰

The Institute generally supports the consolidation of existing FINRA guidance and believes that it is useful to have a clear delineation of requirements in this regard. We would ask, however, for clarification regarding the use of state income tax rates. Historically, firms have been permitted to depict illustrations using an assumed state tax rate. We believe that, where illustrations are not being targeted to a particular state's investors, it is entirely appropriate to include an assumed state tax rate. It would be overly burdensome to require firms to tailor all illustrations to particular states, and we believe it is potentially misleading to investors to fail to demonstrate the impact of state taxes on an illustration. Therefore, we would request that IM-2210-1 clarify that, while such illustrations may only reflect actual state tax rates when used only with investors in that state, it is permissible to use an assumed state tax rate in general communications, provided it is clear from the surrounding disclosure that the state tax rate is an assumed one.

X. Application of IM-2210-2 to Institutional Sales Material

IM-2210-2 as proposed would apply to all communications with the public about variable insurance products, other than institutional sales material. The Institute supports excluding institutional sales material from IM-2210-2. However, we note that paragraph (d)(1) of FINRA's Conduct Rule 2211, "Institutional Sales Material and Correspondence," currently provides that "[a]ll institutional sales material and correspondence are subject to . . . the applicable Interpretive Materials under Rule 2210" We recommend that paragraph (d)(1) of Rule 2211 be revised so that it would be consistent with the proposed institutional sales material exclusion of IM-2210-2.

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²⁰ The remaining requirements would include: (1) depicting both taxable and tax-deferred investments using identical investment amounts and identical assumed gross rates of return of ten percent or less; (2) using and identifying actual federal income tax rates; (3) reasonably reflecting the tax bracket of the particular audience for target audiences; (4) if illustrations cover the payout period for an investment, reflecting the impact of taxes during that period; (5) not assuming an unreasonable period of tax deferral; and (6) disclosing, if applicable, the extent to which tax rates on capital gains and dividends would affect the taxable investment's return and state its underlying assumptions and tax impact from early withdrawals.

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September 30, 2008
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We appreciate the opportunity to comment on the Proposed Rules. If you have any questions regarding our views, please contact me directly at (202) 326-5920 or Ari Burstein at (202) 371-5408.

Sincerely,

/s/ Heather Traeger

Heather Traeger
Assistant Counsel