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December 13, 2007

Dr. Hung
Project Manager
RAND Study of Broker-Dealer and Investment Advisory Issues
By email delivery

Re: Submission of Life Insurance Industry Views on RAND Study

Dear Dr. Hung:

We greatly appreciate the opportunity to share the views of the life insurance industry on the subjects under examination in the RAND Study. ACLI is a national trade association with 373 members that account for 93 percent of the industry's total assets, 91 percent of life insurance premiums, and 95 percent of annuity considerations.

Our members offer and distribute life insurance, annuities and other products through affiliated and independent distributors, including broker-dealers and investment advisers. Many insurance salespersons have attained specialized professional designations, such as the CFP Board's Certified Financial Planner (CFP) designation or the Chartered Financial Consultant (ChFC) designation administered by the American College. The life insurance industry, therefore, is within the scope of the RAND Corporation's examination of broker-dealer and investment adviser functions and regulatory standards.

Life insurers and their salespersons fulfill comprehensive networks of regulation administered by state insurance departments, the Securities and Exchange Commission, and self-regulatory organizations, such as the FINRA. Quite simply, the insurance sales process is one of the most heavily regulated financial services in the marketplace today. Much of our submission and its accompanying attachments outline the products, services and regulation of life insurers and their distributors.

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Objectives of the RAND Study

The scope and purpose of the RAND study provide a critical yardstick to measure whether the project will fulfill its charge objectively and thoroughly. According to the SEC, the core purposes[1] of the RAND Study are to:

- Identify the financial products, accounts, programs and services, including advisory services such as, for example, financial planning and discretionary asset management, provided to individual investors by broker-dealers and investment advisers, and the context in which they are provided;
- Learn how these products, accounts, programs and services are marketed to individual investors;
- Determine the fees and costs paid by individual investors for the products, accounts, programs and services provided;
- Determine how and from what other sources broker-dealers, investment advisers and their associated persons are compensated for the different financial products, accounts, programs and services they offer to individual investors;
- Identify the information provided to individual investors, whether orally, in sales literature, required statements, or in account agreements, regarding the products, accounts, programs and services provided, including the nature of the responsibilities that the broker-dealer or investment adviser owes to the investor and any contractual limitations on those responsibilities;
- Evaluate individual investors' understanding of the marketing and other information provided to them regarding financial products, accounts, programs and services; and
- Evaluate individual investors' expectations regarding the obligations owed to them by the investment professional providing the financial products, accounts, programs and services.

According to the SEC, RAND was hired to elicit views on these core issues from interested parties, including industry groups, regulators, self-regulatory organizations, and investor advocates.[2] The SEC also directed RAND to learn about current industry practices in the marketing, sale and delivery of financial products, accounts, programs and services to individual investors by broker-dealers and investment advisers, including the:

- Marketing and advertising of such products, accounts, programs and services;
- Titles used by investment professionals;
- Communications and disclosures, oral or written, used in connection with the offer of such products, accounts, programs and services;
- Fees and costs of such products, accounts, programs and services; and
- Compensation received by broker-dealers and investment advisers from other sources for the different products, accounts, programs and services they offer to individual investors.

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[1] Exchange Act Rel. No. 34-54077 ( ).

[2] Id.

The SEC visualizes the RAND report as a "first-class empirical study," that "will collect, categorize, and analyze *empirical* data from a *wide variety* of sources."[3] Ultimately, the SEC will rely on the RAND Study to devise the most effective legal and regulatory means to govern broker-dealers' and investment advisers' services, programs, and products to individual investors.[4]

Interests of the Life Insurance Industry

Life insurers and their agents have a direct and significant role in almost all of the products, services and functions that RAND will examine under the "core purposes"of its study. Life insurers create and market products and services that constructively address consumers' retirement, estate, tax, and financial planning needs. Over 50% of FINRA's universe of 675,000 registered representative work for broker-dealers affiliated with life insurance companies. These broker-dealers, however, are quite different from wire-house broker-dealers in structure, operation, products and services.

A principal element of insurance product distribution involves eliciting customer needs and matching them with appropriate insurance and annuity products. Similarly, many life insurance agents provide essential financial planning services in the sale of life and annuity products. Some life insurance agents are also associated with registered investment advisers as a result of their functions and services. These functions may be quite different, however, from what are commonly understood as investment advisory services.

In short, life insurers' products, functions, services and regulation fit within the scope and purpose of the RAND Study. It is critical, therefore, that the RAND Corporation properly include the unique products, services and regulation within its "first-class empirical study." Absent inclusion, the RAND Study will be significantly incomplete and will not provide a solid foundation for the SEC to evaluate effective regulation of broker-dealers and investment advisers.

We are greatly concerned that the RAND Study will principally focus on the products, services, functions, and regulations of wire-house broker-dealers and "typical" investment advisers. RAND appropriately met with large trade associations representing these types of firms. RAND's exposure to products, services, and regulations of life insurers and their distributors, however, appears to be comparatively limited. As soon as the SEC granted RAND the contract to conduct the Study, ACLI volunteered with the SEC staff to meet with RAND and a delegation of representative insurers and distributors. We understood ACLI would be included on the RAND list of industry representatives for interview and dialog.

Late in the RAND Study period, however, we learned that RAND had chosen not to meet with ACLI, although it never communicated its decision. We continue to offer our willingness to actively participate in the RAND analysis notwithstanding reports that the study will be completed by year-end. It is more important to have a balanced, fully inclusive process than it is

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[3] SEC Press Release 2006-162 (Sept. 26, 2006)at http://www.sec.gov/news/press/2006/2006-162.htm .

[4] Id.

to meet arbitrary report deadlines with an incomplete understanding of the landscape under study.

We have provided this written submission for review by RAND in its study to outline the important and significant role life insurers and their distributors play in the investment advisory and broker-dealer world, but strongly encourage active supplemental dialog between ACLI, its members and RAND to fully execute the worthwhile purposes of the SEC's award of the RAND contract. In this way, the RAND report will genuinely function as a "first-class empirical study," that "will collect, categorize, and analyze *empirical* data from a *wide variety* of sources."[5] This more complete process will better serve the SEC, investors and financial service institutions as a foundation to evaluate effective regulation of broker-dealers and investment advisers.

The Interrelationship of Life Insurers' Products and Regulations

In order to meet the varied needs of consumers and the demands of a highly competitive marketplace, life insurers offer a wide range of financial products and services. Increasingly, these products and services implicate the federal securities laws, including broker-dealer regulation by the SEC and FINRA under the Securities Exchange Act of 1934 (the 1934 Act) and regulation by the SEC under the Investment Advisers Act of 1940 (the "Advisers Act"). Life insurers must also fulfill a comprehensive set of state insurance laws and regulations in every U.S. jurisdiction.

As a result, life insurers and their affiliates frequently find themselves subject to the overlapping requirements of the 1934 Act, the Advisers Act, and the insurance and securities regulations of the fifty states. The RAND Study will provide a meaningful opportunity to improve investor protection and while enhancing the efficiency and effectiveness of regulatory oversight.

With the decline of defined benefit pensions and the uncertain health of federal safety net programs like Social Security and Medicare, financial services consumers in the United States bear increasing personal responsibility for their own financial well being. Life insurers and their affiliates, like other financial services providers, have responded to consumers' needs with a wide range of products and services. These products and services often include:

- term life insurance
- fixed and variable cash value life insurance
- disability income insurance
- long term care insurance
- many variations of fixed and variable annuity contracts
- investment brokerage services, including: stocks, bonds, mutual funds, ETF's, and 529 savings plans
- investment advisory services, including: financial planning, fee based wrap accounts, and separately managed accounts

[5] SEC Press Release 2006-162 (Sept. 26, 2006)at http://www.sec.gov/news/press/2006/2006-162.htm .

- individual and business retirement planning
- estate planning and trust services
- non-qualified employee benefit consulting
- 401(k) and other qualified plan design, funding and administration

In order to meet the requirements of the federal securities laws, many of these services are delivered through affiliated broker-dealers and investment advisers subject to the federal securities laws. For example, individual variable life insurance contracts and variable annuities are “securities” under the federal securities laws. Accordingly, these contracts are distributed by registered broker-dealers often referred to as “insurance affiliated” or “independent” broker-dealers.

Life insurers have expanded their products and services to meet a wider range of customer needs that also trigger additional regulatory structures, such as FINRA governance over variable product distribution. Historically, FINRA has relied on a “rules based” approach to regulation. FINRA regulations add considerable complexity to life insurers’ enterprise-wide compliance operations that must also fulfill comprehensive regulation by all state insurance departments. Recently, the SEC approved FINRA Rule 2821, a rare single-product suitability rule for the distribution of individual variable annuities. Rule 2821 is significantly more granular and demanding than FINRA Rule 2310 governing all other securities sales. We mention this to simply demonstrate that insurance products and distributors face more layers of consumer-protective regulation than any other product in today’s financial services marketplace. The new, detailed requirements of Rule 2821 are discussed in detail in the appendix.

The Investment Advisers Act also has an increasing impact on insurers and their affiliates. Some insurers have offered investment advisory services for many years and others may not yet offer any today. On an industry-wide basis, however, life insurers and their producers are increasingly present in investment advisory functions and regulations. There are many factors driving this trend. One significant factor is simply the industry’s effort to meet consumers’ increasing need and demand for investment advice. Recent regulatory developments have only hastened that trend.

Until October 1 of this year and in keeping with the recommendations of the Tully Report, insurance affiliated broker-dealers could offer “fee based” or “fee in lieu” investment accounts without registering as Investment Advisers. That is no longer the case. On March 30, 2007, the United States Court of Appeals for the D.C. Circuit issued a ruling vacating SEC Rule 202(a)(11)-1, which had permitted these fee based accounts as an exception to the Advisers Act. The court’s ruling took effect October 1, 2007. Accordingly, insurance affiliated broker-dealers who want to continue offering fee based investment accounts now must do so through advisory – not brokerage – programs.

Although that Rule 202(a)11-1 has now been vacated, its original issuance in April 2005 also stimulated insurance affiliated broker-dealers to offer services under the Advisers Act. For example, the rule clarified that certain services, including discretionary accounts and certain kinds of “wrap” fee programs, did not meet the requirements of the broker-dealer exclusion and therefore needed to be offered by an RIA. The rule also decreed that comprehensive “financial planning” could no longer be considered “solely incidental” to brokerage services. By virtue of this rule, financial planning would have been considered an advisory service regardless of whether firms charged a separate fee for financial planning advice. Although this rule has been vacated, it did have the effect of brining more activity by insurers under the umbrella of the Advisers Act.

Through the evolution of insurer's business into broker-dealer and investment adviser areas, insurance agents may wear several distinct, but separate, "hats" in offering these services to the public. For example, a representative may at the same time be an appointed insurance agent (generally of multiple insurance companies), a registered representative of a broker-dealer, an investment adviser representative, and possibly a solicitor who may make referrals to others, such as other investment advisers, banks, or trust companies. Different regulatory schemes apply to the representatives' activities, depending upon the products or services offered. In the case of variable insurance products, multiple regulations apply to the same transaction because these products are considered to be both insurance and securities products. Insurers and their affiliates also face the challenge of meeting demanding new sets of comprehensive laws under Sarbanes-Oxley, Graham-Leach-Bliley and the Bank Secrecy Act for practices that were originally designed to meet the requirements of state insurance regulations.

In other cases, such as financial planning combined with implementation of various product solutions, different regulations might apply to the various aspects of the same customer relationship. For example, a client might have an advisory relationship for purposes of receiving a financial plan that is subject to the Advisers Act. That same client might also elect to purchase an insurance policy or execute securities transactions, which are each subject to differing regulatory requirements. Similarly, a single client might have an advisory account in addition to a brokerage account. While a single representative can be qualified to service both accounts, and might in fact service both accounts, different rules and standards apply to each. Needless to say, the multiple regulatory schemes that apply to the actions of a single representative pose demanding challenges in terms of training and supervising the salespersons.

Insurers provide significant written disclosures at the point of sale to satisfy multiple regulators' requirements and to help customers understand the nature of various products and relationships. These disclosures include many product related materials (insurance sales illustrations, policy contracts, mutual fund prospectuses), marketing materials describing the firm's offerings, documents that provide the terms for a brokerage or advisory relationship (brokerage account agreements, advisory account agreements, Form ADV, investment policy statements), and other required disclosures (privacy policy statements, for example). There also is a considerable amount of post-sale disclosure depending on the nature of products and services provided (in-force insurance ledgers, transaction confirms, period performance reporting for investment accounts, updated privacy statements and ADV brochures, as required in some cases). If it would be helpful to RAND in connection with its Study, we can provide samples of these kinds of documents.

The Relationship Between Investment Advice and "Incidental" Activities

In adopting Rule 202(a)11-1, the SEC commented extensively on the nature and extent of advice that broker-dealers could provide under the "solely incidental" component of the B-D exclusion. While the SEC received competing comments on the topic, it concluded that "broker-dealers have traditionally provided investment advice that is substantial in amount, variety, and importance to the consumer." While some financial service observers have challenged the validity of this conclusion, the reality of the marketplace is that broker dealers, including insurance affiliated broker-dealers, do indeed offer valuable guidance and expertise to clients in the context of individual product sales.

Given the importance and individual nature of their own financial needs coupled with the ever-increasing array and complexity of financial services available, individual consumers benefit from analysis and advice about product and service choices. This principle is at the heart of existing broker-dealer regulation, which imposes suitability obligations on firms who make product recommendations to their clients and prospects. These suitability obligations require that firms make an effort to obtain personal and financial information from those customers and that they have "reasonable grounds for believing that the recommendation is suitable for such customer . . . " FINRA Rule 2310. In recent years, this general suitability standard has been applied to ensure that firms act in the best interest of their customers. Based on good business practices and encouraged by the requirements of the federal securities regulators, insurance affiliated broker-dealers are expected to and do provide meaningful analysis and advice as part and parcel of their sale of products to consumers.[6]

Given the range of insurance products available and the tax benefits that apply to those products, it is worth pointing out that the analysis and advice that accompanies insurance product sales might differ in kind from the incidental advice offered by other broker-dealers. For example, beneficiaries of life insurance proceeds do not pay income tax on the death benefit. Moreover, because life insurance proceeds provide liquidity at an insured's death, it can be an effective vehicle for funding estate plans. Life insurance also might be used to help fund non-qualified employee benefits for employers of all sizes. Life insurance, long term care insurance, and annuities – which provide a lifetime stream of income – also are likely to play important parts in meeting the retirement needs of the baby boom generations and others to come. Depending on the nature of products and services offered, these products and ancillary services currently might or might not fall under the federal securities laws. As the scope and requirements of those laws are reevaluated, it will be important to consider how any changes

[6] In another example of rapidly evolving conduct standards, on May 31, 2007, the Certified Financial Planner Board of Standards, Inc. (CFP Board) announced the adoption of updated *Standards of Professional Conduct* that establish ethical standards for CFP professionals. Many life insurance agents hold the CFP designation. CFP professionals found in violation of CFP Board's ethical standards may be subject to public discipline. In 2005, the CFP Board proposed revisions to its ethical standards in light of the evolving role and functions of investment advisers and financial planners. Among other things, the initiative would clarify the scope of fiduciary duty standards for individuals holding the CFP designation. The revisions also establish and refine a number of threshold definitions involving financial planning. A second set of revisions was circulated in March 2007. ACLI filed letters of comment on the two stages of the proposals, noting the unique role and different functions performed by life agents in the distribution of insurance products. The submission recommended that traditional insurance distribution activities should not be pulled into the CFP standards and fiduciary duty requirements when agents are not engaged in financial planning. ACLI's recommendations for change were reflected in the final amendments to the CFP Board's Ethical Code and Standards. The updated Standards will become effective July 1, 2008.

will impact the ability of consumers to access the wide range of products, services, and advice that they need to meet their financial security needs.

The Unique Nature of Broker-Dealers Affiliated with Life Insurers

Broker-dealers affiliated with life insurance companies are significantly different from "wire-house" broker-dealers in their operations, products and services. The securities activities of broker-dealers affiliated with life insurers are a component of a larger insurance business. Many registered representatives operate principally as life insurance and annuity salespersons. Securities sales frequently constitute an incidental amount of business relative to insurance product sales by an office or registered representative.

The range of products offered by these limited purpose broker-dealers is typically constrained and focuses upon the distribution of variable insurance contracts and mutual funds. It may be helpful to consider those securities activities and services *not* offered by most broker-dealers affiliated with life insurers. Typically, these firms do not maintain discretionary accounts permitting registered representatives to purchase and sell securities on behalf of a client without specific approval of each transaction. On an industry-wide basis, these broker-dealers generally do not take custody of client funds, securities or assets. This type of firm does not typically "carry" customer accounts.

Insurance broker-dealers usually require that payment for variable insurance or securities products be made by check payable to the processing office, and not by check payable to the agent/registered representative. Variable contracts and shares in investment companies are issued directly to purchasers and do not constitute bearer instruments. Consequently, the opportunity for misappropriation of these instruments by registered representatives is virtually nonexistent.

Broker-dealers affiliated with life insurers generally do not maintain "open accounts" or facilitate the implementation of stop orders and limit orders, which obviates many potential brokerage problems. These broker-dealers do not generally engage in "principal trades," so one of the central issues identified in the broker-dealer/investment adviser conflicts discussion does not typically apply to broker-dealers affiliated with life insurers. Similarly, because these broker-dealers do not typically make available cash management accounts or manage free cash balances, many associated operational and logistical difficulties are absent. Broker-dealers affiliated with life insurers do not make markets in securities or underwrite new issues of securities. This obviates common pressures for unsuitable sales practices.

In several instances, the federal securities laws and FINRA regulations provide appropriate regulatory exceptions because these limited purpose broker-dealers are different from full service broker-dealers. For example, SIPC membership is not required (or allowed) because these entities do not make margin loans or take custody of customer assets or securities. Similarly, net capital requirements do not apply since these limited purpose broker-dealers. In the same way, the RAND Study should carefully parse the unique structure, activities, and regulation of these limited purpose broker-dealers from the much broader functions and regulatory issues associated with wire-house broker-dealers.

Avoidance of One-size-fits-all Analysis

Even though over 50% of FINRA's population of 675,000 registered representatives work for broker-dealers affiliated with life insurers, FINRA regulations and proposals often overlook the unique structure, operation and products of life insurers. A recent example may help illustrate this phenomenon and provide constructive guidance for objective balance in the RAND Study as it will be used to design significant regulatory modifications.

In Notice to Members 07-12, FINRA invited comment on proposed amendments to NASD Rule 3010 (g), which defines the terms "Office of Supervisory Jurisdiction" and "Branch Office" in the NASD supervision rule. The notice explained that FINRA and the New York Stock Exchange (NYSE) "announced a plan to work jointly to harmonize their rulebooks in an effort to eliminate duplicative rules and streamline regulation." The proposed Rule 3010 amendments were the SROs' first endeavor in the harmonization project.

Because the NYSE rules did not contain a definition of OSJ, FINRA proposed to eliminate this definition from NASD Rule 3010. FINRA noted that the amendment would "prevent locations from being classified as branch offices under Rule 3010(g) where the only activity being conducted is principal review and approval of research reports." As part of this endeavor, FINRA had also proposed the creation of several new definitions, including "supervisory branch office," a "limited supervisory branch office," "non-supervisory branch office" and "non-branch office."

The notice indicated that joint NYSE-NASD committees reviewed all the collective NASD and NYSE rules involving sales practices, supervision, financial and operational obligations, registration, qualifications and continuing education requirements to bring the two organizations' rulebooks "into line." The notice explained that the proposal is a "critical step toward ending duplication and reducing regulatory inefficiency." The notice also explains that the NASD and the NYSE announced a plan on November 28, 2006, to consolidate operations into a new organization that will be the single SRO for all broker-dealers. The harmonization project, therefore, will remain a continuing priority for the SROs.

Unfortunately, the initiative failed in several fundamental respects, and presented a worrisome harbinger of merged NYSE-NASD rules. The life insurance industry emphasized that it will be critical for FINRA to conduct the formidable process of rule harmonization in an even-handed, well-executed manner.

Broker-dealers have established compliance procedures, training materials and supervisory responsibilities based on FINRA's definitions of OSJ, and branch office, and non-branch location. While the creation of new definitions of "limited supervisory branch office," and "non-supervisory branch office" may have appeared simply cosmetic in nature, they would have disrupted substantial enterprise-wide compliance procedures, training practices and supervisory responsibilities for broker-dealers affiliated with life insurers. Compliance manuals, office designations and management procedures would have faced substantial change.

Likewise, the elimination of the OSJ definition would have imposed significant transitional and logistical burdens. Transformational systems costs would have been large under the proposal, especially for firms operating out of numerous, small and geographically dispersed locations. One of our members, for example, distributes its products through 9,000 registered representatives that primarily operate out of one and two person offices. The impact on companies facing these logistics would have been immense. Similarly, the definition of branch office was substantially revised in 2005, transforming to a numerical definitional threshold from a longstanding functional threshold. This revised branch office definition consumed extensive resources in adjustment, supervision, training, compliance procedures, and management. The proposed modifications to the branch office definition so rapidly after its substantial overhaul would have inflicted substantial unnecessary burdens and expenses. The definitional changes would have created an uncharted impact on complying with broker-dealer books and records requirements under the Securities Exchange Act of 1934. None of these issues appeared to have been considered in FINRA's proposed amendment.

The "harmonization" in Rule 3010(g) would have principally benefited 200 wire-house broker-dealers within the total FINRA population of 5,200 broker-dealers. The 5,000 FINRA broker-dealers who are not NYSE members do not face duplicate rule books or disparate SRO rule definitions. Likewise, broker-dealers that are not NYSE members do not typically have locations exclusively limited to supervision and review of research reports. Consequently, the proposed amendment would have principally benefited a select minority of FINRA broker-dealers, and would have imposed collateral burdens on a vast majority of FINRA broker-dealers.

FINRA did not appear to have considered or coordinated the impact of the proposed definitional changes on parallel state securities laws and regulations, which could cause multiple, disparate state and federal categories for broker-dealer offices and locations.
The proposed amendments would have imposed significant operational and compliance costs on broker-dealers. Even worse, the proposal provided no benefit to broker-dealers that are not NYSE members. These factors are were properly addressed in the FINRA Notice to Members.

The burdens of the rule were not balanced against its benefits. Notwithstanding FINRA's earnest statements[7] that the interests of *all* broker-dealers would be fairly represented in the merged SRO, the first "critical step" in "ending duplication and reducing regulatory inefficiency" stumbled in favor of a select group to the detriment of a much larger group of broker-dealers.

Fortunately, on June 6, 2007, FINRA withdrew the proposed changes from consideration in response to industry objections. We highlight this incident to demonstrate that surveys of regulations governing broker-dealers and investment advisers need to be inclusive of the wide variety of business models in those fields.

Balance and Objectivity in the Use of Interviews and Focus Groups

In 2004, the SEC released confirmation and point-of-sale disclosure proposals for mutual funds and variable insurance products, supported in part by a consultant's focus group testing. The use of the focus group study and results were fundamentally troubling, especially regarding conclusions about insurance products and distribution. We highlight this development to

[7] *See* comments of NASD CEO Mary Shapiro before SEC on a consolidated NYSE and NASD (Nov. 28, 2006) at http://www.nasd.com/PressRoom/SpeechesTestimony/MaryL.Schapiro/NASDW_017978 [Consolidation of the SROs "will mean adopting a uniform set of rules *flexible enough to accommodate the different business models and sizes of firms that exist within the industry*" [emphasis added].

amplify our concern that the RAND Study should be properly objective and thoroughly inclusive

of data concerning the structure, operation, products, services and regulation of life insurers and their distributors.

The SEC's 2004 point-of-sale proposal simply indicated that:

> [t]he proposed new rules *respond to concerns*[8] that investors in mutual fund shares, UIT interests (including certain insurance company separate accounts that issue variable insurance products) and municipal fund securities used for education savings lack adequate information about certain distribution-related costs, as well as certain distribution arrangements, that create conflicts of interest for brokers, dealers, municipal securities dealers, and their associated persons.[9]

The proposal failed to demonstrate that the regulatory revisions would have resolved the thinly explained regulatory "concerns." These uncertainties precluded meaningful scrutiny and analysis. The proposal also contained a largely unstated premise that consumers do not read prospectuses. This observation was unsubstantiated in the release.

The initiative's reproposal was quite different from the initial proposal, in purpose and scope. The release stated that:

> [*m]any investors* wanted point of sale disclosure to provide comprehensive information about all the costs of owning covered securities, not just distribution-related costs. They sought comprehensive information about ownership costs, in percentage terms and in dollar terms, to better inform them about the total costs associated with purchasing and owning these securities.[10]

The background and volume of the "many investors" was important to properly and fairly evaluate the initiative. The 2004 release did not specifically identify any commentators or investors making this point, however. Nothing in the release quantified the "many" investors requesting cost disclosure at the point of sale.

In the development of the proposal, the SEC retained consultants to elicit feedback from investors on "comprehensive" cost information in model point-of-sale documents.[11] The direction of the revised proposal relied heavily on the consultant's limited investor interviews. While we respected the SEC's determination to utilize consultants, we questioned the validity of the survey methods used, especially regarding variable contracts.

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[8] Whose concerns? The 2004 release did not quantify or articulate the "concerns" forming the basis for this proposal. Were they the SEC's concerns? Investors? How many? What scope? To what extent did these concerns encompass variable contracts? The answers t these questions were not apparent from the release.

[9] *See* Investment Company Act Rel. No. 26341 (Feb. 10, 2004) at 3.

[10] *See* Investment Company Act Rel. No. 26778 (March 4, 2004) at text accompanying footnote 7 (emphasis added).

[11] The release cites the consultant's reports in footnote 12. *See* Investment Company Act Rel. No. 26778 (March 4, 2004).

The consultants' conclusions were based on individual one-hour interviews with 33 participants.

The report characterizes these surveys as "in-depth" interviews. All participants in the study were required to have purchased a mutual fund within the past two years.[12] The survey screening did not require participants to have experience with variable life insurance or variable annuities. The survey methodology was underwhelming. The report stated that:

> [g]enerally, *respondents had little experience with variable annuities*. While some had actually invested in them, even *they could not clearly describe the features of the product.*

The consultants' report apparently provided a primary foundation for the point-of-sale documents that were expanded to include "comprehensive" cost information. That the proposal was premised on responses from focus group participants without any experience with variable contracts is shocking. The survey appeared unacceptably small to provide "tested" justification for the proposed point-of-sale documents. Moreover, the consultants had not offered survey participants the prospectus Fee Table or Example to address their quest for cost information. We believe the responses would have been far different had participants reviewed this existing cost information.

The participants' background and meager number comprised too small of a sample for reliable research conclusions supporting significant disclosure modifications. While the study reports contained numerous observations, the scope and reliability of the sampling techniques raised significant questions about the validity of the conclusions and the point-of-sale documents they addressed.

We were troubled with a survey using a narrow sample of participants having little experience with variable annuities. The report did not reveal whether the participants understood variable life insurance or had ever purchased a policy. The participants' input on variable contract cost disclosure had limited value, therefore, if any. The sample size for variable contracts was effectively zero because none of the participants had purchased a variable life contract or could clearly describe the features of variable annuities. In our view, the SEC should always base significant new regulatory or disclosure practices on a more substantial and authoritative

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[12] To qualify for the study, each participant: (i) either solely or jointly made investment decisions; (ii) graduated high school, attended some college or graduated college (those with graduate degrees were excluded); (iii) made a mutual fund purchase through a broker in person, over the phone or online in the past (those who had only purchased online were excluded); (iv) made a mutual fund purchase from a financial representative or broker within the past two years; (v) passed an articulateness test. *See* consultant's survey report at 10 [http://www.sec.gov/rules/proposed/s70604/rep110404.pdf and http://www.sec.gov/rules/proposed/s70604/sup-rep010705.pdf].

The survey's participant thresholds are so unfocused that they failed to generate meaningful information. Why were participants with graduate degrees excluded? Why weren't the participants grouped or measured on the basis of economic background to better translate the responses? The survey's approach was principally geared to mutual funds and failed to generate a study population germane to variable contracts. The survey's least common denominator approach yielded unreliable information for purposes of significant SEC rulemaking. While the survey report may provide a collection of generalized feedback, it is hardly sufficient to provide the basis for a "comprehensive" revision of disclosure at the point of sale or for a significant transformation of the initial proposal. Good rulemaking demands better methodology.

foundation. The process of using survey and focus group information in the point-of sale initiative provides instructive lessons for the RAND Study.

Multiple Moving Parts

An impressive number of state and federal initiatives are underway that address the supervision, suitability, and disclosure about variable annuities and insurance product distribution. The May 2006 FINRA "annuity roundtable" produced a number of task forces on these matters that will promulgate recommendations. ACLI participated in the FINRA roundtable and has a proactive CEO Task Force on Annuities that developed a comprehensive initiative on streamlined annuity disclosure and meaningful suitability procedures. State regulators are also actively developing initiatives to address similar matters. With so many moving parts, it will be critically important that the RAND Study project managers understand these issues and the unique aspects of life insurers and their distributors under regulatory and disclosure requirements.

Appendix Materials

We have summarily highlighted and referenced the comprehensive regulatory structures faced by life insurers and their distributors in this letter. We have also provided more extensive discussion about the scope, nature, and evolving status of many of these laws and regulations in the attached appendix materials, especially as they affect the life insurance industry.

Conclusion

We greatly appreciate your attention to our views. We remain greatly concerned that the RAND Study will be incomplete regarding the life insurance industry because only a few insurance industry representatives were asked to participate in the process. Life insurers and their distributors fulfill a more comprehensive set of state and federal regulatory structures than any other financial service institution in today's marketplace. Without a proper understanding and inclusion of these factors, the RAND Study will not fulfill its worthwhile mission. We stand ready to discuss the important role of the life insurance industry in the subjects under study by RAND. Through this process, the RAND report can properly fulfill its core purposes and become a "first-class empirical study," that "will collect, categorize, and analyze *empirical* data from a *wide variety* of sources."

Sincerely,

Carl B. Wilkerson

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