

February 28, 2008

**VIA E-MAIL**

Nancy M. Morris, Esq.  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

Re: **File Number S7-28-07; Comments on the Proposal for Enhanced Disclosure and New Prospectus Delivery Option for Open-End Management Investment Companies**

Dear Ms. Morris:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee").<sup>1</sup> The Committee is pleased to have the opportunity to offer its comments in response to the request of the Securities and Exchange Commission (the "Commission") in Release No. IC-28064 (November 21, 2007) (the "Proposing Release") for comments on proposed amendments to the disclosure and delivery requirements applicable to open-end management investment companies (commonly known as "mutual funds"). The Commission's proposal (the "Proposal") has two primary components: (1) proposed revisions to the current risk/return summary in mutual fund prospectuses to create a new expanded and standardized "summary section" in the front of each prospectus; and (2) proposed revisions to Rule 498 to permit the use of a "summary prospectus" (together, the "Proposed Rules").

As noted, the member companies of the Committee represent over two-thirds of the annuity business in the United States. In some cases, Committee members also offer other financial products, including mutual funds available to the public (sometimes referred to as "retail funds" or "retail mutual funds"). To the extent particular Committee members offer retail mutual funds, these companies may choose to comment on the Proposal from the perspective of their retail fund business. The Committee's comments in this letter, however, focus primarily on how the Proposal would impact the offer and

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<sup>1</sup> The Committee of Annuity Insurers is a coalition of 33 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over two-thirds of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

sale of variable annuity contracts and the mutual funds that are available for investment only as underlying investment options in these contracts (referred to generally as “insurance funds” or “underlying funds”).<sup>2</sup> In this regard, the Proposing Release requested comment on a number of legal and practical issues that, while not framed in the context of variable annuities, could have significant implications for Committee members.<sup>3</sup> Indeed, if adopted, the Proposed Rules could fundamentally alter the manner and form in which disclosure regarding underlying funds is provided to contract owners. This letter offers the Committee’s observations, and in some cases recommends revisions or clarifications, relating to certain specific provisions of the Proposed Rules.

The Committee commends the Commission for its efforts to improve the disclosure provided to mutual fund investors and to encourage and foster a “layered disclosure” process. For the reasons discussed in this letter, however, the Committee believes that certain disclosure proposed to be required in the new expanded fund prospectus summary section is unnecessary and/or unduly burdensome and would have little meaning in the context of insurance funds. The Committee also believes that because of the unique investment structure employed by most variable annuities, certain revisions to the Proposed Rules will be necessary if the use of underlying fund summary prospectuses is to be a viable option for variable annuity issuers.

From a higher-level, policy-related perspective, the Committee believes it important to note that there could be significant negative implications for Committee members and their variable annuity businesses, as well as for millions of retiring Americans, flowing from the fact that the Commission has not proposed new disclosure rules for variable annuities similar to those it has proposed for mutual funds. The Committee appreciates that there are unique and challenging disclosure issues presented by variable annuities. Nonetheless, to the extent that the Proposed Rules significantly improve investors’ understanding of mutual funds and provide more effective means of delivering fund disclosure documents, the Committee strongly believes that investors would similarly benefit if the Commission were to propose corresponding improvements for variable annuity disclosure documents as soon as possible.

Section I of this letter provides an overview of the unique two-tiered investment structure employed by most variable annuities and the resulting implications for the Commission’s Proposal. Section II provides the Committee’s comments and

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<sup>2</sup> 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 Committee’s comments do not address the potential impact of the Proposal on sales of fund shares to these plans.

<sup>3</sup> The Proposal would not directly impact Committee members’ fixed annuity business. Therefore, the comments in this letter focus on variable annuities, which are regulated under the federal securities laws. This letter also does not comment on the impact the Proposed Rules may have on variable life insurance policies. However, it is worth noting that many insurance funds are also offered as investment options in variable life policies.

recommendations regarding the proposed expanded fund prospectus risk/return summary. Section III provides the Committee's comments and recommendations concerning the fund summary prospectus proposal. Section IV concludes with a discussion of the reasons why the Committee believes that the Commission should commit the necessary resources to develop a rule proposal that would require standardized summary sections in variable annuity prospectuses and permit the use of a corresponding variable annuity summary prospectus.

**I. Overview of the Two-Tiered Investment Structure of Variable Annuities and Associated Implications for the Proposed Rules**

**A. Two-Tiered Investment Structure of Variable Annuities**

A variable annuity is a contract between the insurance company issuing the contract and the investor purchasing the contract.<sup>4</sup> Today most variable annuities are issued through a two-tiered investment structure. The top tier consists of a separate account of the issuing insurance company, which is a segregated investment account established under state insurance law that holds variable annuity contract assets and liabilities separate and apart from the assets and liabilities of the insurance company's general account. Absent an exemption from the Investment Company Act of 1940 (the "1940 Act"), a separate account is required to register as an investment company under the 1940 Act. Separate accounts typically are organized and registered under the 1940 Act as unit investment trusts and are divided into subaccounts.

The bottom tier of the two-tiered variable annuity investment structure consists of portfolios of one or more underlying mutual funds, which may include both so-called "proprietary" funds sponsored by the insurance company as well as unaffiliated mutual funds. The current generation of variable annuity contracts typically offers a wide variety of underlying funds. Each subaccount of the separate account corresponds to and is invested exclusively in a portfolio of the underlying funds. This structure permits variable annuities to offer a wide variety of underlying funds as investment options, and gives the contract owner the opportunity to select from dozens of underlying funds offered by many different mutual fund complexes.

For tax reasons, the underlying funds that are available through registered insurance company separate accounts cannot be available directly to the public.<sup>5</sup> Accordingly, mutual fund complexes have created separate funds apart from their retail funds that are only available to insurance company separate accounts (and, as noted, certain qualified retirement plans). Under this structure, variable annuity owners allocate

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<sup>4</sup> 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 the contract. See Stephen E. Roth, Susan S. Krawczyk, and David S. Goldstein, *Reorganizing Insurance Company Separate Accounts Under Federal Securities Laws*, 46 Business Lawyer 546 (Feb. 1991).

<sup>5</sup> See Section 817(h) of the Internal Revenue Code.

premium payments among the subaccounts offered within the contract and may transfer contract value among those subaccounts in accordance with the terms of the contract. Each subaccount, in turn, invests in a corresponding portfolio of an underlying fund.

Operationally, variable annuity contract owners do not engage in transactions in shares of the underlying funds. Rather, contract owner transactions take place in the form of purchases in or redemptions from the subaccounts. To account for amounts allocated to or withdrawn from a subaccount as a result of purchase payments, withdrawals and transfers, values in each subaccount generally are measured in terms of “accumulation units.” Each subaccount has its own accumulation unit value that is distinct from, but derivative of, the net asset value per share of its corresponding underlying fund portfolio. On a daily basis, the insurance company, which is the legal owner of the underlying fund shares, aggregates all orders received from contract owners with respect to each subaccount and transmits net purchase or redemption orders (so-called “omnibus orders”) to the underlying fund portfolio in which the subaccount is invested. The insurance company also recalculates the value of each subaccount’s accumulation units on a daily basis to reflect changes in the corresponding underlying fund’s net asset value.

#### **B. Operation of the Proposed Rules in the Context of the Two-Tiered Investment Structure Applicable To Variable Annuities**

Similar to the registration procedure followed by mutual funds, insurance company separate accounts organized as unit investment trusts use an “integrated” registration form, Form N-4, to register variable annuity contracts as securities under the Securities Act of 1933 (the “1933 Act”) and to register the separate account as an investment company under the 1940 Act. Form N-4 is a three-part form, with a prospectus (the “contract prospectus”),<sup>6</sup> a “Statement of Additional Information” (“SAI”) containing more detailed and technical information, and “Part C” containing exhibits and other information relating to the separate account and its insurance company depositor.

Pursuant to the requirements of Section 5(b) of the 1933 Act, insurance companies issuing variable annuity contracts are required to provide contract prospectuses to purchasers upon the initial sale. Insurers generally also provide updated contract prospectuses annually to current contract owners to satisfy applicable requirements under Section 5(b). Importantly, the Commission considers the offer or sale of a variable annuity contract through a separate account organized as a unit investment trust to be a public offering of the contract *as well as* the shares issued by the underlying funds. Therefore, contract purchasers are required to be provided with underlying fund prospectuses. The obligation to print and deliver underlying fund prospectuses has historically been the responsibility of the insurance company. Prospectuses must be provided for each underlying fund to which the purchaser allocates part or all of the initial purchase payment, and for each fund to which the contract owner thereafter allocates additional purchase payments or transfers contract value from another fund.

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<sup>6</sup> The contract prospectus contains the purchase, sale, and tax information that will be relevant to a variable annuity investor, as well as a description of the underlying funds and of the variable annuity’s features.

Some insurance companies find it more efficient from an administrative standpoint to provide prospectuses for all available underlying funds to contract purchasers or existing owners.

Because of the dual prospectus delivery requirements applicable to variable annuity contracts and underlying funds, prospectus delivery requirements for variable annuity issuers exceed those of retail mutual funds. Thus, there would be significant benefits to both variable annuity issuers and contract owners if insurance companies could satisfy their underlying fund prospectus delivery requirements with summary prospectuses. However, after carefully considering the application of the summary prospectus proposal to variable annuities, the Committee has concluded, for the reasons discussed herein, that without certain revisions to the Proposed Rules, use of the summary prospectus for underlying funds may not be a viable option for many insurers.

## **II. Proposed Revisions to Risk/Return Summaries in Mutual Fund Prospectuses**

The Commission has proposed revisions to Form N-1A, the mutual fund registration statement, that would require the statutory prospectus of every mutual fund to include a summary section at the front of the prospectus consisting of key information for each portfolio, presented in plain English in a standardized order. The revised summary section is designed to provide investors with key information about the fund that investors can use to evaluate the fund and compare it to other funds. The summary section would be available to all investors, regardless of whether the fund also used a summary prospectus, and regardless of whether the investor is reviewing the prospectus in paper or electronic format.

The proposal builds on the risk/return summary currently required in the front of mutual fund prospectuses. The Commission explained in the Proposing Release that although it believes the existing summary has basically functioned effectively to provide investors with key fund information, it has proposed to modify the current format of the risk/return summary in significant ways with respect to both content and format.

While commendable, some of the proposed new disclosure items do not recognize certain characteristics of the two-tier investment structure of variable annuities. Given the inherent differences between the operation of retail funds and insurance funds, the Committee believes that some allowances must be made for insurance funds to provide different, and in some cases less, information than retail funds. For the reasons discussed below, the Committee believes that it is not necessary to provide the same information to investors in both retail funds and insurance funds to achieve the purposes of the Proposed Rules, and that doing so could thwart the purpose of the Proposal by requiring irrelevant and potentially confusing information to be provided to investors.

Accordingly, the Committee respectfully makes the following recommendations regarding the proposed fund prospectus summary requirements. Each of these recommendations is discussed more fully below.

- The Committee recommends that the summary section of an underlying fund prospectus not be required to include disclosure concerning “Purchase and Sale of Fund Shares” or “Dividends, Capital Gains, and Taxes.”
- The Committee recommends that the requirement to disclose a fund’s top ten holdings in the summary section of underlying fund prospectuses be eliminated.
- The Committee recommends that insurance funds not be required to include in their prospectus summaries the proposed legend concerning compensation payments to financial intermediaries.
- The Committee recommends that certain explanatory disclosure be permitted to precede the fee table in the summary section of the prospectus.

**A. Purchase and Sale of Fund Shares and Dividend, Capital Gains, and Taxes**

The proposed amendments to Form N-1A would require purchase and sale and dividends, capital gains, and tax information to be disclosed in the summary section of the prospectus. As noted above, the two-tier structure of a variable annuity means that investors do not own, and therefore do not purchase or sell, shares of underlying funds. The purchase and sale information about which a variable annuity contract owner needs to know relates to purchase payments, transfers, and withdrawals at the contract level. This information is provided in the contract prospectus. Although it may be appropriate for the statutory prospectus of an underlying fund to contain a brief explanation that shares of the fund are sold only to insurance company separate accounts (and in some cases to certain types of retirement plans) and not to the general public, the Committee believes that more detailed information is unnecessary and could be confusing if included in the summary section for underlying funds. The Committee recommends that underlying funds be excepted from this disclosure requirement.

Similarly, distribution of dividends and capital gains by underlying funds is largely irrelevant to variable annuity contract owners. Such funds distribute dividends and capital gains, but they are automatically reinvested in additional fund shares. Separate accounts generally do not pay taxes on distributions by funds of dividends and capital gains. The only tax information relevant to a variable annuity investor is the tax consequences of owning the variable annuity contract, and that information is provided in variable annuity contract prospectuses. Accordingly, the Committee believes that, although it may be appropriate to include a brief explanation in the statutory prospectus, tax information need not be included in an underlying fund prospectus summary section

(or summary prospectus if used) and recommends that the proposed amendments to Form N-1A specifically note this exception.

### **B. Top Ten Portfolio Holdings**

The proposed amendments to Form N-1A would require a fund to disclose its top ten portfolio holdings in the summary section of its prospectus. The Committee questions the usefulness and relevance of this information, particularly in the context of variable annuities. Variable annuity investors have long-term investment goals and may be less concerned with the current investments of underlying funds than retail investors are concerned with the current investments of retail funds. Furthermore, when this information is contained in a statutory prospectus, it will only be updated once per year. Thus, at the time it is shown to a potential investor, it may be very outdated and could confuse investors.

Additionally, to the extent that the Commission has recommended the inclusion of top ten holdings in the summary section because it believes that top ten portfolio holdings information is routinely provided by funds to investors in sales material, the Committee understands that such information is not routinely provided to investors in the context of many underlying funds. Accordingly, the Committee respectfully urges the Commission to reconsider whether top ten holdings information is necessary in underlying fund prospectus summary sections.

### **C. Compensation to Financial Intermediaries**

Under the Proposed Rules, fund prospectus summary sections would be required to conclude with a standardized legend intended to provide fund investors with information about distribution-related costs that may create conflicts for broker-dealers and their associated persons offering and selling fund shares.<sup>7</sup> The new legend would inform fund investors of three things:

- The fund may have compensation arrangements with selling broker-dealers or other financial intermediaries.
- These arrangements may create conflicts of interest.

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<sup>7</sup> Proposing Release at 31.

- Further information may be obtained from their salesperson or the financial intermediary's Web site.<sup>8</sup>

The proposed legend requirement appears similar to the disclosure that would be required for fund prospectuses under the Commission's pending point-of-sale and confirmation rule proposal. Under this proposal, funds that make "revenue sharing" payments as defined in the rules would be required to disclose that such payments are made, and that specific information about the revenue sharing payments is included in the confirmation the investor will receive and in disclosure that would be required to be provided by broker-dealers at the point of sale.<sup>9</sup> In addition to the detailed information that would be required on confirms and on the new point-of-sale form, the Commission asked for comment on whether broker-dealers should be required to provide supplemental information on their Web sites.

It would appear that the Commission will need to adopt final point-of-sale, confirm and broker-dealer Web site disclosure requirements to implement the new legend requirement proposed for fund prospectus summaries. It would appear also that if the Commission decides to adopt a similar disclosure construct for variable annuities, Form N-4 would need to be amended to require contract prospectuses to disclose that (i) the insurer may have compensation arrangements with selling broker-dealers or other financial intermediaries, (ii) these arrangements may create conflicts of interest, and (iii) further information may be obtained from their salesperson or the financial intermediary's Web site. Corresponding rules would need to be adopted to require additional compensation related information about the arrangements to be disclosed on confirms, point-of-sale forms, and broker-dealer Web sites. The Commission has in fact proposed or asked for comments on such requirements for variable annuities.

While the Committee believes that the disclosure construct described above may be appropriate for variable annuities, a number of issues would need to be addressed, none of which were addressed in the Proposing Release. The Committee would be

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<sup>8</sup> Summary sections of mutual fund prospectuses would be required to set forth the following legend:

"Payments to Broker-Dealers and Other Financial Intermediaries

If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may influence the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information."

<sup>9</sup> See *Point of Sale Disclosure Requirements and Confirmation Requirements for Transactions in Mutual Funds, College Savings Plans, and Certain Other Securities, and Amendments to the Registration Form for Mutual Funds*, Securities Exchange Act Release No. 51274 (Feb. 28, 2005), 70 Fed. Reg. 10521 (Mar. 4, 2005) at 10538. See also *Confirmation Requirements and Point-of-Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds; Proposed Rule*, Securities Exchange Act Release No. 49148 (Jan. 29, 2004), 69 Fed. Reg. 6438 (Feb. 10, 2004).

pleased to work with the Commission and its staff to develop a specific proposal for variable annuities, and would refer the Commission in the interim to the detailed comment letters the Committee submitted in connection with the Commission's point-of-sale/confirm proposals.

However, the Committee recommends that the Commission revise the proposed fund prospectus summary legend requirement to exempt insurance fund prospectuses. Otherwise, variable annuity contract owners may be misled into thinking that the funds pay commissions or other types of compensation to the broker-dealers selling the variable annuity contracts. Only if insurance funds sell their shares directly to investors should the proposed disclosure be required.<sup>10</sup> Similarly, the reference in the proposed legend to "other financial intermediary" could be misinterpreted by variable annuity contract purchasers as meaning the insurance company issuing the variable contract. Purchasers would simply be confused were they to ask the salesperson selling them a variable annuity for information about payments from the fund to the salesperson, since the salesperson is compensated by the selling firm with which the salesperson is associated and it is the insurance company, not the fund, that pays such commissions. Moreover, although variable contract prospectuses often contain disclosure about Rule 12b-1 payments from underlying funds to insurers or their affiliates, or payments by fund advisers or other affiliates to insurers for distribution, administrative or other services, to our knowledge such information generally is not currently provided on insurers' Web sites.

#### **D. Fee Table Placement**

The proposed amendments to Form N-1A require placement of the fee table first in the expanded summary section of fund prospectuses before any other information is presented about the fund, except for the fund's investment objective. The Proposing Release explains that the Commission believes that it needs to enhance the prominence of cost information in fund prospectuses, which currently follows information about investment strategies, risks and past performance and, according to the Commission, sometimes appears deep in the prospectus.

The Committee agrees that fund cost information should be prominently disclosed, but submits that cost information in some situations may end up being more prominent in investors' eyes if summary information about the fund is provided before the fee table. This summary information may have the effect not of obscuring, but promoting, understanding of the information regarding fees and charges in the fee table by providing important context to assist in understanding each of the fees and charges listed in the fee table.

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<sup>10</sup> As noted, some insurance funds also sell their shares to certain qualified plans. The Committee takes no position on whether the proposed financial intermediary compensation disclosure should be required in any such type of situation.

### **III. Proposed Mutual Fund Summary Prospectuses**

The new standardized summary section for mutual fund prospectuses is mandatory. The Commission has also proposed a new optional disclosure tool — mutual funds would be permitted to use the summary section of the prospectus on a stand-alone basis as a profile-like “summary prospectus” that would satisfy a fund’s prospectus delivery requirements under Section 5(b) of the 1933 Act, provided certain conditions are met.<sup>11</sup> The summary prospectus proposal would encourage funds to employ a “layered disclosure” approach to providing mutual fund investors with disclosure. That is, a fund would be permitted to use a summary prospectus to satisfy its obligations under Section 5(b) only if it made that summary prospectus, as well as the full statutory prospectus, SAI, and other specified fund documents available on the Internet, with paper copies available upon request. The fund’s Internet prospectus and SAI would, in turn, be required to contain hyperlinks to the summary prospectus to assist investors in being able to quickly navigate the documents to obtain desired information.

Broker-dealers and other financial intermediaries engaged in distributing a fund’s shares would generally be permitted to provide customers with the fund’s summary prospectus to satisfy applicable Section 5 delivery requirements. The applicable document Web-posting requirements would be satisfied if the fund posted the appropriate documents on its own Web site. Alternatively, the broker-dealer or other financial intermediary would be permitted to satisfy the Web-posting requirements by posting the fund’s documents on its own Web site.

Presumably, insurance companies issuing variable annuity contracts would function for purposes of the summary prospectus rules as a “financial intermediary” distributing underlying funds’ shares. Under this interpretation, the insurance company would be able to satisfy applicable fund prospectus delivery obligations by delivering fund summary prospectuses instead of full statutory prospectuses in accordance with the insurer’s current procedures for delivering underlying fund prospectuses.<sup>12</sup>

For insurance companies issuing variable annuity contracts, given the large number of underlying fund investment options typically available in any one variable

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<sup>11</sup> See Proposed Rule 498. Proposed Rule 498 provides that, for purposes of Rule 159 under the 1933 Act (and therefore for purposes of Sections 12(a)(2) and 17(a)(2) of the 1933 Act), fund documents that are properly incorporated by reference into a summary prospectus are deemed conveyed to a person no later than the time the summary prospectus is received, provided continuous Internet availability of the incorporated documents is achieved in formats that permit permanent retention, are convenient for reading both online and in paper, and meet the hyperlinking requirements of the rule.

<sup>12</sup> It is generally understood that an insurance company’s obligation to deliver underlying fund prospectuses stems from the theoretical constructs embodied in Rule 140 under the 1933 Act. Applying Rule 140 in the context of the variable annuity two-tier investment structure may lead to the conclusion that the underlying fund was making an offering of its shares to variable annuity purchasers, and therefore had the prospectus delivery requirements rather than the insurance company; for purposes of the discussion herein, however, we refer to the insurance company as having the obligation.

annuity, the ability to satisfy their Section 5 delivery requirements with respect to underlying fund prospectuses by delivering summary prospectuses instead of full statutory fund prospectuses holds obvious appeal. However, satisfying the corresponding conditions for extensive Web site document posting, hyperlinking, and summary prospectus quarterly updating would present complex legal, technical and logistical issues for variable annuity issuers and underlying funds. Additionally, the requirement in the Proposed Rules that prohibits binding the summary prospectus with other documents, including the contract prospectus and other summary fund prospectuses, is burdensome and generally thought to be unworkable in the variable annuity context.

In summary, under the structure of the Proposed Rules, the Committee notes that some insurers may find it logistically impossible to make use of the underlying fund summary prospectus. In addition, because of the significant costs that would be associated with using underlying fund summary prospectuses and the fact that there may be only a marginal benefit inuring to an insurance company as a result, other insurers may opt not to use underlying fund summary prospectuses. Accordingly, the Committee respectfully provides the following comments. Each comment is discussed in more detail below.

- The Committee requests that the Commission revise the layered disclosure requirements for underlying funds to not require hyperlinking within underlying fund documents posted by an insurance company on its own website.
- The Committee believes that, with respect to quarterly updating of the summary prospectus, the costs far outweigh the benefits, and recommends that quarterly updating not be required for underlying funds.
- The Committee requests that the Commission exempt underlying funds from the restrictions related to document binding contained in the Proposed Rules or, in the alternative, requests confirmation that the Proposed Rules would not prohibit the binding of underlying fund summary prospectuses with each other and with other documents required by law to be delivered to investors at the time of sale.
- The Committee requests confirmation that underlying fund summary prospectuses could be delivered in lieu of full underlying fund statutory prospectuses to satisfy the conditions of the “Great-West” line of no-action letters.

**A. Specific Problems with the Layered Disclosure Approach in the Two-Tiered Investment Structure of Variable Annuities**

Under the proposed revisions to Rule 498, Internet access to a statutory mutual fund prospectus would equal delivery of the prospectus for Section 2(a)(10) or

Section 5(b)(2) purposes only if a number of conditions relating to Web site access and presentation are met. The principal condition would be that a mutual fund's current summary prospectus, statutory prospectus, SAI, and most recent annual and semi-annual reports to shareholders (the "required documents") be made available, free of charge, at a Web site address shown on the cover page or at the beginning of the summary prospectus.<sup>13</sup>

As noted in the previous section, the Proposed Rules contain requirements as to how the required documents must be posted. Notably, there is a "hyperlinking requirement" for the summary prospectus, statutory prospectus, and SAI. Specifically, the information required to be posted on the Web site would be required to be presented in a format that:

- permits persons accessing the statutory prospectus or SAI to move directly back and forth between the table of contents in that document and each section of that document referenced in the table of contents; and
- permits persons accessing the summary prospectus to move directly back and forth between each section of the summary prospectus and (1) any section of the statutory prospectus and SAI that provides additional detail concerning that section of the summary prospectus, or (2) tables of contents in the statutory prospectus and SAI that prominently display the sections within those documents that provide additional detail concerning information contained in the summary prospectus.

As noted above, insurance companies have historically been responsible for the printing and delivery of underlying fund prospectuses. As a result, it is primarily the insurance companies, and not the underlying funds, that stand to benefit from the reduced printing and postage costs of using a summary fund prospectus instead of a full statutory prospectus.<sup>14</sup> Thus, the Committee anticipates that unless the Commission makes the use of a summary prospectus mandatory, many, if not most, underlying funds will elect not to make use of a summary prospectus and not to comply with the onerous Web site posting

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<sup>13</sup> Web site access to a mutual fund's required documents would be mandated on or before the time that the summary prospectus is sent or given. Current versions of these documents would be required to remain on the Web site through a date that is at least 90 days after:

- in the case where Section 5(b)(2) of the 1933 Act is being satisfied, the date that Section 5(b)(2) would require delivery of the statutory prospectus; and
- in the case where a communication with respect to a mutual fund security is being deemed not to be a prospectus under Section 2(a)(10) of the 1933 Act, the date that the communication is sent or given.

<sup>14</sup> In some cases, insurance companies have negotiated participation agreements under which underlying funds do share a portion of the printing costs attributable to the fund prospectus.

requirements in the Proposed Rules, since the underlying funds generally would not have financial incentives to take on these additional obligations.<sup>15</sup>

As a result, if an insurance company wants to be able to use summary prospectuses for underlying funds in lieu of delivering full statutory prospectuses, the Committee expects that the insurance company will be required to coordinate with each underlying fund and take the initiative to post the required documents itself on its own Web site. However, as discussed below, practical and legal considerations will likely determine whether insurers will decide to take on this responsibility and the responsibility to deliver requisite additional fund documents in paper and electronic format upon request. Among other concerns, failure to provide the required access to the hyperlinked documents, failure to use formats that permit permanent retention of the hyperlinked formats, failure to post documents that are convenient for reading both online and in paper, or failure to mail or email fund documents in a timely manner upon request could, under the Proposed Rules, have significant legal implications for the satisfaction of a fund's prospectus delivery requirements under Section 5(b) of the 1933 Act and the timing of compliance with Rule 159 under the 1933 Act.

Under proposed Rule 498, much rests on compliance with paragraph (f) of the Proposed Rule. A fund's obligations under Section 5(b)(2) of the 1933 Act are satisfied only if the summary prospectus is delivered as required by the rule and the conditions of paragraph (f) are met. Similarly, as noted above, for purposes of Rule 159 under the 1933 Act, information is deemed conveyed not later than the time the summary prospectus is received, provided, among other things, paragraph (f) is satisfied. Paragraph (f) requires not only website posting of the required documents for specified periods, but also requires posting in hyperlinked formats of certain fund documents in a manner that can be permanently retained by the investor. Paragraph (f) provides a limited safe harbor if not all conditions of the paragraph are met, provided the fund has reasonable procedures in place to ensure compliance with its conditions, and the fund takes prompt action to ensure compliance as soon as practicable.

In order for an insurance company to be able to post the required documents for each underlying fund, there will need to be a significant level of coordination between insurers and underlying funds. For example, there is a question of how to tailor the cover page of a fund's summary prospectus so that it could be used with multiple insurers and variable annuity contracts. There are also the enormous logistical challenges presented by having to quickly coordinate with outside funds on the receipt, posting and hyperlinking of multiple required documents from each of the dozens of underlying funds for each variable annuity contract.

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<sup>15</sup> To the extent that some underlying funds prepare summary prospectuses and the insurance company is unable to provide summary prospectuses for those that do not, the Committee notes that some members have expressed concern as to any negative inferences that might be drawn from summary prospectuses being provided for some underlying funds but full prospectuses for others.

The Committee believes that, due to the cost and operational challenges of posting the required documents in the required format for each underlying fund, most insurance companies will choose not to use summary prospectuses in lieu of statutory prospectuses – at least in the short run. In order to facilitate the use of summary prospectuses for underlying funds, the Committee recommends that the Commission allow insurance companies to post the required documents on their own websites without the required hyperlinks and related requirements.

As noted above, the Committee believes that producing properly hyperlinked documents and posting them in the required format in a timely manner will be costly and burdensome for the underlying funds. The Committee also believes that, today, many insurance funds do not have websites. Thus, in order to use a summary prospectus, an underlying fund would be required to devote significant financial and human resources to compliance with the Proposed Rules, without receiving any discernable benefit. Thus, the Committee believes it is highly unlikely that underlying funds will post the required documents with the required hyperlinks unless the Commission requires underlying funds in the insurance product context to assume this responsibility.

To the extent that the Commission does not make the use of the summary prospectus mandatory, the Committee recommends that the Commission permit insurance companies to post the required documents on their own websites without the hyperlinks described in the Proposed Rules. As noted above, many variable annuities offer investors multiple underlying funds from multiple fund families. Simply posting the required documents for all underlying funds in a timely manner would be a logistically challenging task for any insurance company to undertake. However, Committee members believe that it would be possible for many insurance companies to post the required documents in PDF format in a timely manner so long as the documents were not required to contain hyperlinks.

Considering the number of underlying fund documents for which a typical insurance company would have to produce hyperlinks, the task of properly hyperlinking underlying fund documents would be extraordinarily challenging for many insurance companies. Today, an insurance company typically receives the updated prospectuses for all of the underlying funds only days before those prospectuses become effective and must be used.<sup>16</sup> It would be practically impossible under these conditions for one insurance company to create hyperlinks within all of the required documents and post them on its Web site within the required timeframe.

Additionally, the technology of hyperlinking is relatively new. The Committee's understanding is that most insurance companies would have to hire special computer

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<sup>16</sup> Insurance companies are required by state law to have a fiscal year that ends on December 31<sup>st</sup>. For administrative ease, with very few exceptions, underlying funds have adopted a similar fiscal year end as the insurance companies that offer the funds, thus triggering a May 1<sup>st</sup> registration statement update for the vast majority of underlying funds and variable annuities.

programmers or contract with outside vendors in order to accomplish this task. Furthermore, an approach where the insurance company is responsible for hyperlinking the required underlying fund documents would require insurance companies to assume unprecedented liability for the posting and coding of underlying fund documents.<sup>17</sup>

Accordingly, the Committee requests that the Commission allow insurance companies to post the required documents on their own websites without the required hyperlinks. Alternatively, the Committee requests that the Commission defer compliance with the portions of the Proposed Rules requiring hyperlinking of documents for underlying funds for at least three (3) years. A deferral period would allow time for technological advances that would, hopefully, facilitate more cost-effective compliance with the Proposed Rules.<sup>18</sup> However, the Committee notes that a deferral period will not address insurance companies' concerns regarding legal liability issues.

## **B. Quarterly Updating of Summary Prospectuses**

Proposed Rule 498 would require that a fund's average annual total return and yield data provided in a summary prospectus be updated to show performance as of the end of the most recent calendar quarter, not less than one month after the completion of the quarter. In addition, the fund's "top 10" portfolio holdings would need to be updated on the same schedule as the performance information.

Even if the Commission addresses the Committee's concerns set forth in the previous section, requiring quarterly updates to summary prospectuses may make it impracticable for many insurers to use underlying fund summary prospectuses. For one, a quarterly updating requirement would compound the operational and liability issues discussed in the preceding section of this letter. There may be additional considerations as well. For example, some insurers (perhaps a majority) typically provide so-called "sales kits" to broker-dealers offering and selling their variable annuity contracts. If quarterly updating were required, selling firms would be required to pull these sales kits apart on a quarterly basis in order to affix the proper updates to the proper summary prospectuses. Additionally, ensuring that all distribution channels are provided with quarterly updates for all underlying funds could be a significant logistical challenge for insurance companies. Most variable annuities simply have too many underlying fund options to make this feasible. As a result, the resources that an insurance company would

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<sup>17</sup> The legal implications under the Proposed Rules for financial intermediaries, such as insurance companies, that perform hyperlinking for a fund are unclear. Among other things, the safe harbor provided under subparagraph (f)(4) of Proposed Rule 498 appears to be available only if the fund itself has "reasonable procedures" in place to ensure compliance with the conditions of paragraph (f), whereas this letter contemplates scenarios in which an insurance company, as the intermediary, would be responsible for such compliance.

<sup>18</sup> If the Commission chose to defer compliance with the portions of the Proposed Rules requiring hyperlinking of documents, there is, of course, no guarantee that sufficient technological advances would occur during this period to permit insurance companies to cost-effectively and efficiently hyperlink documents.

be required to devote to complying with a quarterly update requirement would likely far outweigh any corresponding benefits the insurer would experience.

### **C. Ability to Bind Summary Prospectus with Other Documents**

Proposed Rule 498 stipulates that Section 5(b)(2) of the 1933 Act would be satisfied if, among other things, (i) a summary prospectus is sent or given no later than the time of the delivery of the mutual fund security, and (ii) if any other materials accompany the summary prospectus, the summary prospectus is given greater prominence than those materials and is not bound together with any of those materials. However, the Proposing Release does not address whether Rule 498 would permit several summary prospectuses for different fund portfolios to be bound together into one document.

As mentioned above, a common practice among variable annuity contract issuers is to use “sales kits” to manage the requirement to deliver multiple documents at the time of sale of a variable annuity. These sales kits are used, in part, to ensure that a sales representative does not overlook a required disclosure document when meeting with a potential investor.

In the Proposal, the Commission’s stated rationale for requiring that the summary prospectus not be bound with other documents is that the summary prospectus should be given prominence. However, in the context of a variable annuity, this concern is not present. The document that should be given prominence when selling a variable annuity is the contract prospectus. Thus, the Committee suggests that the rationale for requiring retail fund summary prospectuses to not be bound with other documents is not applicable in the context of an insurance fund investment option in a variable annuity. Therefore, the Committee requests that the Commission exempt underlying funds from the binding restrictions contained in the Proposed Rules or, in the alternative, requests confirmation that the Proposed Rules would not prohibit the binding of underlying fund summary prospectuses with other documents required by law to be delivered to investors at the time of sale of a variable annuity.

### **D. “Great-West” Variable Annuity Contracts**

The Committee requests that the Commission confirm that underlying fund summary prospectuses could be delivered in lieu of full underlying fund statutory prospectuses to satisfy the conditions of the “Great-West” line of no-action letters, provided that all the conditions of the Proposed Rules are met.<sup>19</sup>

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<sup>19</sup> *Great-West Life and Annuity Insurance Company* (pub. avail. October 23, 1990).

#### **IV. Need for a New Variable Annuity Prospectus and Summary Prospectus**

With the Proposal, the Commission has acknowledged the need for an improvement in the mutual fund disclosure regime. Likewise, the Committee believes that the time has come for a fresh look at the regulatory construct under the federal securities laws for variable annuity contract disclosure documents. Sales of variable annuities exploded dramatically in the 1990s, and continue to be robust. The size of this market (total assets of over \$1.3 trillion) is indicative of the critical role variable annuities are playing already, and are expected to play going forward in helping millions of Americans plan for their retirement and achieve other long-term financial goals. Recent studies and press articles have made it clear that variable annuities will play a critical role in providing guaranteed lifetime income for millions of retiring Americans in the coming years.<sup>20</sup>

The products themselves are undoubtedly becoming more complex. Recent innovations make variable annuities look unlike any other product on the market. Contracts offer portfolio management tools such as dollar cost averaging and portfolio rebalancing. Contracts offer enhanced death benefits, “living benefits,” payout protections such as payment floors and levelized payments, and commutation features. The number of investment options available has also increased significantly. The Committee believes that the importance and increasing complexity of variable annuities argue strongly for a new standardized risk/return summary for variable annuity contract prospectuses, a variable annuity summary prospectus consistent with the new “layered” disclosure approach proposed for mutual funds, and that the Commission devote the necessary resources so that such an approach for variable annuities can be formally proposed as soon as possible.

#### **Conclusion**

The Committee appreciates the opportunity to comment on the Proposed Rules as they apply to variable annuities and urges the Commission to consider carefully the revisions offered by the Committee in this letter to make the use of underlying fund summary prospectuses feasible for insurers issuing variable annuity contracts. Additionally, the Committee encourages the Commission to begin developing a summary

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<sup>20</sup> See e.g. “Annuities and Retirement Well-Being,” Constantijn W.A. Panis, Pension Research Council, The Wharton School, University of Pennsylvania (2003); “Barclays Adds Annuity Feature To 401(k)s,” Investment News (Oct. 10, 2007) (stating that Barclays is introducing a 401(k) program that creates a new way for employers to give deferred contribution plan participants the longevity protection of a defined benefit plan); “Strategies Can Keep Money Flowing,” The Columbus Dispatch, by Humberto and Georgina Cruz (Sept. 11, 2007) (describing recent report published by the Fidelity Research Institute, “Structuring Income for Retirement,” that shows that longevity risk is a serious issue facing retirees and that variable annuities with minimum lifetime withdrawal guarantees and lifetime income annuities are ways to successfully address longevity risk); “Annuities with Promise,” Kimberly Langford, Kiplinger’s Retirement Report (August 2007) (observing that variable annuity guaranteed withdrawal benefits and income benefits help people approaching retirement to protect against the risk of starting withdrawals in a down market).


Nancy M. Morris, Esq.  
February 28, 2008  
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section for variable annuity prospectuses and a corresponding summary prospectus for variable annuities. The Committee looks forward to assisting the Commission in this endeavor in any way possible.

Respectfully Submitted,

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FOR THE COMMITTEE OF ANNUITY INSURERS

cc: The Honorable Christopher Cox  
The Honorable Paul S. Atkins  
The Honorable Kathleen L. Casey  
Andrew J. Donohue, Division of Investment Management  
Susan Nash, Division of Investment Management

APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

AEGON USA, Inc.  
Allstate Financial  
AIG Life Insurance Companies  
AmerUs Annuity Group Co.  
AXA Equitable Life Insurance Company  
Commonwealth Annuity and Life Insurance Company  
Conseco, Inc.  
Fidelity Investments Life Insurance Company  
Genworth Financial  
Great American Life Insurance Co.  
Guardian Insurance & Annuity Co., Inc.  
Hartford Life Insurance Company  
ING North America Insurance Corporation  
Jackson National Life Insurance Company  
John Hancock Life Insurance Company  
Life Insurance Company of the Southwest  
Lincoln Financial Group  
MassMutual Financial Group  
Merrill Lynch Life Insurance Company  
Metropolitan Life Insurance Company  
Nationwide Life Insurance Companies  
New York Life Insurance Company  
Northwestern Mutual Life Insurance Company  
Ohio National Financial Services  
Old Mutual Life Insurance Company  
Pacific Life Insurance Company  
Protective Life Insurance Company  
Prudential Insurance Company of America  
RiverSource Life Insurance Company  
*(an Ameriprise Financial company)*  
Sun Life Financial  
Symetra Financial  
The Phoenix Life Insurance Company  
USAA Life Insurance Company