

WHITE PAPER
ON
FINRA's REGULATION OF SALES OF ANNUITIES BY
SECURITIES FIRMS

March 19, 2008

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The Committee of Annuity Insurers

INTRODUCTION

We have prepared this White Paper on behalf of our client, the Committee of Annuity Insurers,¹ in connection with the recent correspondence between the Financial Industry Regulatory Authority, Inc. (“FINRA”) and the Iowa Insurance Division (“FINRA/Iowa Correspondence”).² The FINRA/Iowa Correspondence clarifies the manner in which an insurance company may fulfill its supervisory obligations with respect to annuity transactions sold through a broker-dealer.

By way of background, Iowa, similar to many other states, has adopted the National Association of Insurance Commissioners’ Suitability in Annuity Transactions Model Regulation (“Model Regulation” or “Model”). The Model Regulation imposes certain supervisory obligations on an insurance company with respect to its annuity transactions. In order to fulfill these supervisory responsibilities, an insurer may contract with a third party (such as a broker-dealer) to maintain supervisory policies and procedures with respect to that party’s insurance producers.³ The Model Regulation further requires an insurance company choosing to contract with a third party to maintain a supervisory system to make a “reasonable inquiry” to the third party to ensure the required policies and procedures are in place.⁴

The FINRA/Iowa Correspondence clarifies that under Iowa’s version of the Model Regulation, an insurance company will be deemed to have satisfied its supervisory obligations with respect to both fixed and variable annuity transactions if it obtains a certification from a producer stating that the producer: (a) is a registered broker-dealer and a member of FINRA, and (b) supervises sales of the insurance company’s annuity contracts by the distributor’s registered representatives. The certification is not required to be contained in a separate document. Rather, it may be included in the selling agreement with the producer.

The Committee believes that the guidance provided by the FINRA/Iowa Correspondence will help lead to a rational and effective regulatory framework regarding annuity sales through a broker-dealer. In order to advance the framework established by the guidance, the Committee believes that it is critical to understand FINRA’s comprehensive requirements regarding sales of variable annuities, as well as the requirements applying to fixed annuity sales when sold through a broker-dealer. This White Paper seeks to provide this background in clear and practical terms.

¹ 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.

² A copy of the correspondence is attached at Appendix B.

³ NAIC Model Regulation (Section 6D).

⁴ *Id.*

EXECUTIVE SUMMARY

FINRA imposes an extensive regulatory framework on its broker-dealer member firms selling variable annuities. FINRA's framework is multi-dimensional, and is comprised of comprehensive rules regulating members' conduct, a robust examination and enforcement program, and an educational and compliance outreach program.

FINRA member firms are subject to rules that cover every facet of a firm's business including:

- Membership
- Suitability and sales practices
- Payment of compensation
- Handling of customer complaints
- Review, content and filing of marketing communications
- The establishment of a supervisory system and internal compliance program

Since the mid-1990s, FINRA (previously known as the "NASD" or the National Association of Securities Dealers, Inc.) has provided a comprehensive set of rules, bulletins, and guidance concerning variable annuity sales. Most notably, FINRA recently adopted Rule 2821 governing the sale and exchange of deferred variable annuities. This rule (effective May 5, 2008) will overhaul the variable annuity sales process by securities firms.⁵ The rule supplements FINRA's general suitability rule and creates specific recommendation requirements, expanded principal review and approval requirements and supervisory and training requirements.

FINRA supplements its rulemaking with a robust examination and enforcement program. Recently, these programs have placed particular emphasis on variable annuity sales.

- FINRA's examination program has established protocols targeting variable annuity sales practices, looking at such things as
 - replacement activity,
 - suitability, and
 - communications used with the public.
- It has also undertaken various "sweep" examinations, which review variable annuity sales practices across a number of firms.
- FINRA's examination and enforcement programs are facilitated by the extensive recordkeeping and complaint reporting requirements to which firms are subject. These requirements have been revised in recent years in order to help FINRA identify problematic sales practices at firms.
- Where examinations, including those involving variable annuity sales practices, discover that members have failed to comply with its rules or the federal securities

⁵ One aspect of the rule, related to the required timing of principal review, has been delayed until August 4, 2008.

laws, FINRA will discipline firms and their associated persons by imposing sanctions ranging from censures to fines, suspensions and expulsion from the industry.

While most of this White Paper's focus is on variable annuities, it is important to note that although fixed annuities are generally outside the province of FINRA oversight, many broker-dealers choose to subject fixed annuity sales to the firm's supervision. In such cases, fixed annuity sales would be reviewed for suitability by the broker-dealer, related marketing pieces would be reviewed, and other requirements would apply. It should also be noted that some fixed annuity products are registered, and in such cases are subject to FINRA's rules.

In addition to its traditional regulatory role, FINRA engages in a number of activities designed to educate the investing public and provide compliance-oriented tools for securities firms. In the last few years, many of these efforts have centered on annuities. These efforts include:

- Publishing a number of educational pieces regarding annuity sales and developing a series of podcasts.
- FINRA staff has announced publicly that it is developing an industry utility (sometimes referred to as the variable annuity contract database) to serve as a repository for data about generally available variable annuity products. The database is intended for use by variable annuity distributors and would include information about important contract features as well as fees and expenses.

GLOSSARY

Associated Person- an individual who works for or acts on behalf of a broker-dealer.

Branch Office- an office of a broker-dealer that is held out as a location where it conducts its securities business.

Chief Compliance Officer (CCO) – the officer of a broker-dealer who is designated by the broker-dealer as having overall accountability for its compliance efforts.

Duty to Supervise – the requirement placed on broker-dealers to supervise and control its activities and the conduct of its representatives.

NASD Conduct Rules- that portion of the NASD rules covering sales practices, retail selling activity, and operational matters.

Office of Supervisory Jurisdiction (OSJ)- an office of the broker-dealer which supervises its business and where supervisors are resident.

Principal – a person with supervisory functions at a broker-dealer.

Representative- an individual licensed through a broker-dealer to conduct activities on behalf of the broker-dealer. A representative is also an Associated Person (see above).

Suitability- the principle that, in recommending a securities transaction to a customer, a broker-dealer and its registered representatives must have reasonable grounds for believing that the transaction is suitable for the customer's financial and investment circumstances and objectives, based upon the facts disclosed by the customer.

Supervisory Controls- the complete set of controls in place at a broker-dealer to assure compliance with applicable laws and regulations as well as its own policies and procedures.

Written Supervisory Procedures- a written set of policies and procedures that every firm is required to create and maintain and which are tailored to the specific business in which the broker-dealer engages.

Note: We use the terms “securities firms,” “firms,” “members” and “broker-dealers” to mean an entity registered as a broker-dealer with the U.S. Securities and Exchange Commission and a member of FINRA.

DISCUSSION

I. FINRA Overview

FINRA was created in July 2007 through the consolidation of the National Association of Securities Dealers, Inc. (“NASD”) and New York Stock Exchange’s (“NYSE”) departments regulating its members. Today, FINRA is the largest self-regulatory organization (“SRO”) for securities firms doing business in the United States, overseeing nearly 5,000 brokerage firms. It operates from main offices and through 15 District Offices around the country.

FINRA’s role in the securities industry grows out of the Securities Exchange Act of 1934 (“1934 Act”) which provides that direct, day-to-day regulatory authority over broker-dealers is carried-out by SROs. While the day-to-day oversight of broker-dealers is conducted by FINRA, the SEC exercises oversight responsibility by approving FINRA rules and rule changes, examining FINRA and reviewing FINRA actions and determinations.

FINRA performs wide-reaching functions with respect to broker-dealer regulation. It sets admission and continuing qualification standards for its members and their associated persons. It also establishes business conduct rules covering member firms and their registered representatives. FINRA examines securities firms on a regular basis and is also authorized to sanction members for non-compliance.

Most of the rules that we discuss in this White Paper are contained in the NASD’s Conduct Rules, which is that portion of the NASD’s rules covering sales practices, retail selling activity and operational matters.

II. Regulatory Framework Applying to Variable Annuity Sales Practices

In this section, we examine FINRA rules governing variable annuity sales practices. We begin our discussion with a review of FINRA’s suitability rules and then look at rules covering marketing material.⁶ We then turn to rules requiring firms to adopt and implement a supervisory system over sales activity and a formalized compliance program. We conclude with a brief review of the rules regulating compensation arrangements.

A. Requirements Governing the Suitability of Variable Annuity Transactions

FINRA has a comprehensive framework designed to ensure that firms have robust processes to determine the suitability of variable annuity transactions. NASD Rule 2821, which will take effect on May 5, 2008, is a targeted rule applying to variable annuity transactions. It supplements the general suitability rule, Rule 2310. In addition, FINRA has published guidance with respect to variable annuity exchanges. Each of these are discussed below, in turn.

⁶ While we generally refer herein to FINRA rules, the rules have not technically been re-named as such and are also referred to sometimes as “NASD Rules.”

1. NASD Rule 2821

Rule 2821, a rule targeting to the supervision of annuity sales, becomes effective on May 5, 2008.⁷ The Rule creates recommendation requirements (including a heightened suitability obligation), expanded principal review and approval requirements, and supervisory and training requirements with respect to deferred variable annuity (“variable annuity”) transactions.⁸

Recommendation Requirements. Rule 2821 will require that a member or person associated with a member recommending a purchase or exchange of a variable annuity has a reasonable basis to believe that such a transaction is suitable in accordance with the general suitability rule, Rule 2310. In particular, there must be a reasonable basis to believe that:

- The customer has been informed, in general terms, of various features of variable annuities;
- The customer would benefit from certain features of variable annuities, such as tax deferred growth, annuitization, or a death or living benefit; and
- The particular variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and the riders and similar product enhancements are suitable (and in the case of an exchange, the transaction as a whole also is suitable) for the customer based on the information the member or person associated with the member is required to make a reasonable effort to obtain pursuant to the rule.

Further, in the case of exchanges there must also be consideration regarding whether:

- the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits, or be subject to increased fees or charges;
- the customer would benefit from product enhancements and improvements; and
- the customer’s account has had another deferred variable annuity exchange within the preceding 36 months.

The associated person recommending the transaction will be required to document these considerations and sign this documentation.

The Rule also requires a member or a person associated with a member to make reasonable efforts to obtain from the customer information regarding the customer’s age, annual income,

⁷ As noted above, one aspect of the rule related to the required timing of principal review has been delayed until August 4, 2008.

⁸ The rule covers supervision and recommendation requirements with respect to the original purchase or exchange of a deferred variable annuity and subaccount allocations. The rule is not applicable to payments made after the initial purchase or exchange of a deferred variable annuity. In addition, the rule does not apply to reallocations of subaccounts made after the initial purchase or exchange of a deferred variable annuity. Further, the rule does not apply to transactions involving any employer-sponsored retirement or benefit plan that is defined as a “qualified plan” under section 3(a)(12)(C) of the 1934 Act or meets the requirements of sections 403(b), 457(b), or 457(f) of the Internal Revenue Code, but would apply to recommendations made to individual qualified plan participants.

financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable by the member or person associated with the member in making recommendations to customers.

Principal Review and Approval. Rule 2821 will require that a registered principal review a transaction and determine whether he or she approves of it prior to transmitting the customer's application to the issuing insurance company for processing, but no later than seven business days after the customer signs the application. The registered principal may approve the transaction only if he or she has determined that there is a reasonable basis to believe that the transaction would be suitable based on all of the factors noted above.

Rule 2821 will require that for purposes of reviewing variable annuity purchases and exchanges, a registered principal must treat all transactions as if they have been recommended. However, if a registered principal determines that a transaction, which is not suitable based on the factors noted above, was not recommended, he or she may nonetheless authorize the processing of the transaction if the customer has been informed of the reason why the transactions has not been approved and the customer affirms that he or she wants to proceed with the transaction.

The registered principal that reviews the transaction must document and sign the determinations that the proposed rule requires him or her to make. He or she must complete this documentation regardless of whether he or she approves, rejects, or authorizes the transaction.

Supervisory Procedures and Training. Rule 2821 will require members to develop and maintain supervisory procedures that are reasonably designed to achieve compliance with the rule. Members would be required to implement surveillance procedures to determine if associated persons "have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of [t]he Rule, other applicable NASD rules, or the federal securities laws." Members would also be required to have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.

Rule 2821 will require members to develop and implement training programs that are tailored to educate registered representatives and registered principals on the material features of deferred variable annuities and the requirements of the proposed rule.

2. NASD's Suitability Rule Applying to Recommended Transactions—Conduct Rule 2310

NASD Rule 2310 require securities firms to have reasonable grounds for believing that a securities recommendation made to a customer is suitable for that customer. This rule applies to all securities, including variable annuities. Under Rule 2310, in recommending a security, a broker-dealer must meet the requirement of reasonable basis suitability and customer-specific

suitability.⁹ The concept of reasonable basis suitability places an obligation on broker-dealers to have an adequate and reasonable basis for a recommendation, regardless of the customer to whom the recommendation is made. To discharge its reasonable basis suitability obligation, a member must perform appropriate due diligence to ensure that it understands the nature of the product, as well as the potential risks and rewards.

Customer-specific suitability refers to a broker-dealer's obligation to tailor a recommendation to a customer's financial profile and investment objectives. Thus, a broker-dealer may not recommend a security unless it believes that the security is appropriate for the customer based upon the information that the broker-dealer has obtained from the customer.¹⁰

Rule 2310 also provides that, prior to the execution of a transaction recommended to a retail customer, a member must make reasonable efforts to obtain information concerning:

- the customer's financial status;
- the customer's tax status;
- the customer's investment objectives; and
- such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.¹¹

3. Guidance Concerning Variable Annuity Exchanges

As noted above, Rule 2821 imposes comprehensive requirements regarding variable annuity exchanges. In addition to these requirements, FINRA has provided securities firms with additional guidance regarding such exchanges.

First, as we discuss in Section IV below, specific guidance has been provided regarding exchanges of variable annuities into equity indexed annuities. In Notice to Members 05-50 (August 2005), FINRA reminds members that all recommendations to liquidate or surrender a registered security such as a mutual fund, variable annuity, or variable life contract must be suitable, including where such liquidations or surrenders are for the purpose of funding the purchase of an unregistered equity indexed annuity.

Notice to Members 07-06 ("NTM 07-06") expresses FINRA's concerns about replacements of variable annuities and other products in the context of registered representatives switching firms. NTM 07-06 deals with the general situation where a registered representative who has switched firms faces impediments in continuing to sell or service variable products to his or her existing client base. NTM 07-06 notes that in such situations, the representative may be tempted to cause

⁹ NASD Notice to Members 01-23 established broad criteria for determining whether a customer communication is a recommendation subject to suitability requirements, and covers online communications.

¹⁰ See, e.g., FINRA Regulatory Notice 07-43 and NASD Notice to Members 05-59.

¹¹ NASD Conduct Rule 2310(b).

his or her existing clients to replace their mutual fund and variable annuity holdings with new products offered by his or her new firm. NTM 07-06 states that such replacements must be suitable based on the customer's investment needs.

NTM 07-06 states that in determining suitability a firm may consider the fact that it lacks a dealer or servicing agreement with the product sponsor and therefore, the representative cannot provide the customer with ongoing service. However, the suitability consideration must also include other factors such as whether the existing fund or variable product is subject to a contingent deferred sales charge and the fees and expenses associated with the new product being recommended. NTM 07-06 calls for firms to maintain procedures that are specifically designed to prevent problematic transactions recommended by newly-transferred representatives.

B. Controls Over Marketing Material: Review, Content and Filing Requirements

NASD Rules include extensive requirements for communications used by securities firms and their registered representatives. Firms' "advertisements" and "sales literature" are required to comply with specific content standards. Among other things, such communications must be fair and balanced, may not omit any material fact, and may not predict or project performance.¹²

In addition to these content standards, NASD rules require that prior to use, all advertising and sales literature must be reviewed and approved by a registered principal of the broker-dealer. Further, sales material must be filed with FINRA. FINRA staff reviews filed sales material and informs firms whether the material submitted complies with the cited rules, any changes that are necessary to bring the material into compliance, and, if applicable, FINRA staff provides an explanation why the material should not be used.

FINRA has set forth additional standards that must be considered with respect to variable products. NASD IM 2210-2 establishes guidelines for advertisements and sales literature for variable life insurance and variable annuities. The guidelines discuss how all communications must clearly describe the product as either a variable life insurance policy or a variable annuity. There must also be no representation or implication that these types of securities are short term, liquid investments. Presentations regarding liquidity must be clear and balanced, describing the negative impact of early redemption. The safety resulting from guarantees on these products must not be overemphasized or exaggerated.

C. Requirement to Adopt and Implement a Supervisory System Over Sales Activity

The NASD Rules provide detailed standards and requirements with respect to a firm's supervision of sales. NASD Conduct Rule 3010 requires firms to establish and maintain a system to supervise the activities of registered representatives and associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations and the NASD Rules.

¹² NASD Conduct Rule 2210.

1. Written Supervisory Procedures

A firm is required to establish and maintain written procedures for the supervision of each type of business the member maintains and the supervision of its registered representatives and associated persons. The procedures are required to set forth the supervisory system established by the firm, including the titles, registration status and location of all supervisory personnel and the responsibilities of each supervisory person as they relate to a firm's business, the securities laws, and NASD Rules.

2. Chain of Supervision

A firm is required to maintain a written record (commonly referred to as the "chain of supervision") showing the immediate supervisor for each registered representative and associated person.

3. Approval of Transactions

A firm is required to follow certain review procedures to ensure supervision of transactions. Securities transactions must be endorsed by a registered principal, and a firm's accounts may be accepted only by an officer or manager at an OSJ.

4. Approval of Correspondence

Firms are required to establish procedures for the review by a registered principal of incoming and outgoing written and electronic correspondence of their registered representatives with the public relating to its securities business.

5. Annual Compliance Meetings with Representatives

A firm is required to conduct annual meetings or interviews with registered representatives to discuss compliance matters relevant to the activities of the representatives.

6. Office Designations

Firms are required to classify the various locations in which it or its associated persons carry out their activities, to identify supervisors for each such location, and to assign particular supervisory responsibilities to each of the locations. In particular, each location has to be classified as either an: Office of Supervisory Jurisdiction ("OSJ"), branch office, or an unregistered location.

7. Inspections

Firms are required to inspect each OSJ and supervisory branch at least annually. Non-supervisory branches must be inspected, at a minimum, every three years. Non-branch locations are required to be inspected on a regular, periodic basis.

8. “Outside” Activities of a Representative

NASD Rules set forth specific requirements with respect to registered representative activities that are outside the scope of the firm’s business. Registered persons are prohibited from being employed by, or receiving compensation from, another person as a result of any business activities outside the scope of his relationship with the firm unless he has provided prompt written notice to the firm. In addition, firms’ associated persons are prohibited from participating in any manner in a private securities transaction except with the approval or acknowledgement of the member. Further, if the person is to receive selling compensation from a private securities transaction, the firm is required to supervise the participation and record the transaction on its books and records.

9. Continuing Education Requirements

Registered Persons must comply with continuing education requirements. FINRA’s Continuing Education requirements contemplates two elements: a Regulatory Element and a Firm Element. The Regulatory Element entails an interactive computer course administered at FINRA-approved training and testing centers. The Firm Element requires firms to maintain a “continuing and current” education program for its registered representatives who have direct contact with customers in the conduct of the member’s securities sales, trading, and investment banking activities, and for the immediate supervisors of such persons. Firms are required to evaluate and prioritize their training needs at least annually and develop a written training plan. Such plan must take into consideration a firm’s size, organizational structure, scope of business activities, as well as regulatory developments and the performance of registered persons in the Regulatory Element. The Firm Element is independent from, and is not satisfied through the Annual Compliance Meeting described above.

D. Requirement to Establish an Effective Compliance Program

Firms are required to have formalized compliance programs. Each firm is required to designate a chief compliance officer and also requires each firm’s chief executive officer to certify **annually** to having in place a process to establish, maintain, review, modify and test the firm’s compliance policies and supervisory procedures.¹³ Further, firms are required to establish internal controls that include processes to independently test and verify the firm’s supervisory system.¹⁴

E. Controls Over Compensation

A number of FINRA rules regulate compensation practices for variable contracts. More specifically, certain provisions focus primarily on non-cash compensation arrangements and prohibit a firm or associated person from receiving any non-cash compensation arrangements except in certain specified situations.¹⁵ The rules contain exceptions for small gifts and occasional meals and entertainment, certain training and educational meetings, and certain

¹³ NASD Conduct Rule 3013.

¹⁴ NASD Conduct Rule 3012.

¹⁵ NASD Conduct Rule 2820.

incentive-based arrangements based on total production of an associated person with regard to variable contracts where credit given for each contract is equally weighted.

III. Examinations and Enforcement

In order to verify broker-dealer compliance with FINRA rules and the federal securities laws, FINRA conducts an active inspection program. From FINRA's standpoint, examinations serve a fundamental regulatory purpose, that is to cause widespread, consistent compliance with the investor protection standards embodied in the securities laws. From a broker-dealer's perspective, examinations serve as a constant reminder that a firm must have in place up-to-date compliance systems, policies and procedures that cover all of its business lines. Firms that fail to comply with NASD Rules may be subject to disciplinary action.

Securities firms generally are examined on a "cycle" basis that ranges from annually to once every four years, depending on the firm's business activities, methods of operation, types of products sold and disciplinary history. These exams are referred to as "routine" exams.

Routine examinations of members selling variable annuities will typically focus on, among other things:

- the review of the firm's supervisory structure;
- case file reviews to assess the suitability of variable annuity sales, including not only the appropriateness of the recommended contract, but also the appropriateness of any additional features or benefits;¹⁶
- suitability considerations regarding recommendations made by newly associated registered representatives to replace mutual funds or variable annuities;
- customer complaints;
- the effectiveness of the firm's surveillance efforts to review inappropriate activity; and
- unusual account activity.

In addition to routine exams FINRA conducts:

- "For cause" exams. These types of exams are conducted in response to customer complaints, terminations of associated persons for cause and other events.
- "Branch" exams. Examines high-risk branches for compliance with rules related to trading and market conduct.
- "Sweep" exams. Coordinated set of exams regarding practices, products or areas of interest that cut across the industry.¹⁷

¹⁶ FINRA, Routine Exams: Improving Examination Results- May 2007; In Notice 07-43, FINRA noted that examiners are closely looking at withdrawal penalties or other limits on liquidity, such as deferred variable annuities and equity indexed annuities, and variable life settlements.

¹⁷ FINRA Webcast, What to Expect: Preparing for an NASD Routine Examination, October 23, 2007.

Over the past few years, a number of FINRA's sweep examinations have focused on variable annuity sales practices. One such sweep was conducted in 2004.¹⁸ Another sweep looked at exchanges from variable annuities into equity indexed annuities. The sale of variable annuities is also being reviewed in a current sweep involving sales to seniors.¹⁹

FINRA has wide-ranging enforcement authority to enforce the federal securities laws and also FINRA's rules. FINRA's enforcement focus related to variable annuities has run parallel to the explosive growth of variable annuity sales over the past ten or so years. Where FINRA has determined there to be wrongdoing, it has not shied away from imposing stiff penalties and other types of sanctions against securities firms and associated persons. These cases have alleged various types of deficiencies including inadequate supervision of sales of variable annuities and unsuitable sales to customers.²⁰

IV. Requirements with Respect to Sale of Fixed Annuities

Fixed annuities are generally outside the province of FINRA. Nevertheless, many broker-dealers subject fixed annuity sales to supervision. In such cases, fixed annuity sales would be reviewed for suitability, marketing pieces would be reviewed, and other requirements would also apply. It should also be noted that some fixed annuities are registered, and in such cases would be subject to FINRA's rules and subject to broker-dealer supervision.

FINRA directly deals with the issue of broker-dealer supervision of unregistered equity indexed annuity products in Notice to Members 05-50 ("NTM 05-50"). In NTM 05-50, FINRA cautions that, given the factual nature of whether an equity indexed annuity is a "security" under the Securities Act of 1933, a broker-dealer runs certain risks in not supervising sales of unregistered equity indexed annuities on the assumption that the product is not a security. NTM 05-50 requires that representatives notify their firm if they are selling unregistered equity indexed annuities. In addition, NTM 05-50 advises that firms should adopt special procedures with respect to equity indexed annuities and highlights the following practices that some firms have adopted and which all firms should consider:

- supervise equity indexed annuity sales as a "private securities transaction";
- maintain an approved list of acceptable unregistered equity indexed annuities (and prohibit the sale of any other unregistered equity indexed annuity without special approval);
- require all sales of equity indexed annuities to occur through the firm (meaning that the firm must supervise the marketing material, conduct suitability analysis and other sales practices in the same manner that it supervises the sale of securities); and

¹⁸ Remarks of Mary L. Schapiro, Vice Chairman, NASD, NASD Fall Conference, October 14, 2004.

¹⁹ Elisse B. Walter, Executive Vice President Regulatory Policy and Oversight, Before the Committee on Aging, United States Senate Hearing on Elderly Investment Fraud, March 29, 2006. This sweep is being coordinated with the SEC and state securities regulators.

²⁰ See Letter from James S. Wrona, Associate Vice President and Associate General Counsel, FINRA, to Nancy M. Morris, Secretary U.S. Securities and Exchange Commission, dated August 13, 2007 (summarizing recent FINRA enforcement cases involving variable annuities).

- conduct proper training with respect to the equity indexed annuity's features and the extent to which the equity indexed annuity meets the needs of a particular customer.

Many broker-dealer firms have adopted some—if not all—of these recommendations.

In addition, NTM 05-50 reminds broker-dealers that all recommendations to liquidate or surrender a registered security such as a mutual fund, variable annuity, or variable life contract must be suitable, including where such liquidations or surrender are for the purpose of funding the purchase of an unregistered equity indexed annuity product. This is consistent with previous FINRA statements, including those made in a Regulatory & Compliance Alert in 2002.²¹ FINRA's view of its jurisdictional reach with respect to securities liquidations is further reflected in the context of certain FINRA sweep examinations where FINRA has requested information from firms with respect to the liquidation of securities products to fund the purchase of equity indexed annuities.

²¹ NASD Regulatory & Compliance Alert (Spring 2002).

CONCLUSION

Sales of variable annuities are subject to comprehensive sales practices and other rules by FINRA. Many broker-dealers subject unregistered fixed annuities products to many of these same rules. The FINRA/Iowa Correspondence seeks to leverage the established FINRA framework that is in place rather than to establish an overlapping or conflicting regulatory framework.

We also note that the FINRA framework has been enhanced over the past few years to better address annuity sales by broker-dealers and to assist FINRA in identifying and addressing problematic sales practices.

Accordingly, the Committee of Annuity Insurers supports the extension of the guidance provided by the FINRA/Iowa Correspondence to each of the other states that have adopted suitability regulations based on the National Association of Insurance Commissioners' Suitability in Annuity Transactions Model Regulation.

APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

AEGON Insurance Group
AIG Life Insurance Companies
Allstate Financial
AmerUs Annuity Group Co.
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company (a Goldman Sachs 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 American 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
OM Financial Life Insurance Company
Pacific Life Insurance Company
The Phoenix 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
USAA Life Insurance Company



Financial Industry Regulatory Authority

APPENDIX B

Thomas M. Selman
Executive Vice President
Corporate Financing/
Investment Companies Regulation

August 13, 2007

James R. Mumford
First Deputy Commissioner
Iowa Insurance Division
300 Maple Street
Des Moines, Iowa 50319

Dear Mr. Mumford:

I am writing to confirm your interpretation of the manner in which an insurance company may fulfill its obligations under IAC Regulation 191-15.68 (507B) – 15.73 (Suitability in Annuity Transactions) and IAC Regulation 191-16.21 (507B) – 16.30 (Replacement of Life Insurance and Annuities).

The rules adopted by Iowa regarding suitability in annuity transactions are modeled on the Suitability in Annuity Transactions Model Regulation approved by the National Association of Insurance Commissioners in 2006. Similarly, Iowa's rules governing the replacement of life insurance and annuities are modeled on the NAIC's Life Insurance and Annuities Replacement Model Regulation. Like both Model Rules, Iowa's regulations impose obligations on insurance companies with respect to the supervision of recommendations made by distributors of the company's products.

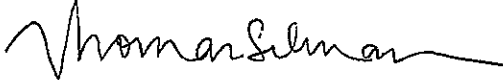
I am writing to seek your confirmation that an insurance company will be deemed to have satisfied its obligations under the above-referenced rules with regard to the supervision of distributors if it obtains a certification from the distributor stating that the distributor (a) is a registered broker-dealer and a member of FINRA; and (b) supervises sales of the insurance company's annuity contracts by the distributor's registered representatives. This certification may be part of its selling agreement with the distributor.

Based on our conversations, I understand that we will engage in discussions on a quarterly basis, and as needed, concerning any significant insurance-related trend, discussed on a non-specific firm basis. Of course, your office would continue to have the opportunity to submit an access request for information concerning public enforcement matters. Please let me know if this understanding is incorrect in any way.

Mr. James R. Mumford
August 13, 2007
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I appreciate your consideration of these issues and look forward to hearing from you at your earliest convenience.

Very truly yours,

A handwritten signature in cursive script that reads "Thomas M. Selman". The signature is fluid and extends across the width of the text area.

Thomas M. Selman
Executive Vice President



STATE OF IOWA

CHESTER J. CULVER
GOVERNOR

SUSAN E. VOSS
COMMISSIONER OF INSURANCE

PATTY JUDGE
LT. GOVERNOR

FINRA
9509 Key West Avenue
Rockville, MD 20850-3329

Attn: Mr. Thomas M. Selman

August 20, 2007

Dear Mr. Selman:

This letter is in response to your letter to me dated August 13, 2007 relating to working together to enhance customer protection concerning the sale of insurance products through the broker-dealer distribution system. We realize the efforts FINRA undertakes, and the tools available to FINRA, to assure that broker-dealers under its jurisdiction have in place a system to assure sales of securities (as defined under Federal law) are suitable for the purchaser.

Recognizing that, I am confirming that an insurance company will be deemed to have satisfied its obligations, under rules referenced in your letter, with regard to the supervision of distributors if the company obtains a certification from the distributor stating that the distributor (a) is a registered broker-dealer and a member of FINRA; and (b) supervises sales of the insurance company's annuity contracts by the distributor's registered representatives in accordance with FINRA rules and jurisdiction. We understand that the certification may be part of the selling agreement.

We also agree to engage with FINRA in discussions on a quarterly basis, or as needed, concerning any significant insurance-related trend. The discussions will be on a non-specific firm basis but we would continue to have the opportunity to submit access request for information concerning public enforcement matters.

The effort of the Iowa Insurance Division and FINRA to work closely together as outlined in our correspondence should strengthen our resolve to assure the suitable sale of insurance products through the broker-dealer system. I hope it is the beginning of future efforts to use the expertise and authority of both jurisdictions to solve issues when products and distribution systems cross jurisdictional lines. This cooperation is not intended to replace any regulatory or statutory authority we have as an insurance regulator if we determine a broker-dealer has not met its obligation under the Iowa rules.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Mumford", written over a horizontal line.

Jim Mumford
First Deputy Commissioner
Iowa Insurance Division
jim.mumford@iid.state.ia.us
515-281-6836