

MEMO# 22788

August 11, 2008

FINRA Requests Comment on Proposal Governing Communications About Variable Insurance Products; Conference Call Scheduled for August 20

[22788]

August 11, 2008

TO: VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 22-08 RE: FINRA REQUESTS COMMENT ON PROPOSAL GOVERNING COMMUNICATIONS ABOUT VARIABLE INSURANCE PRODUCTS; CONFERENCE CALL SCHEDULED FOR AUGUST 20

The Financial Industry Regulatory Authority (“FINRA”) has published a proposed rule change to modify, simplify and codify its guidance governing member communications with the public about variable insurance products. [\[1\]](#) Specifically, the proposal would change the guidelines on illustrations of tax-deferred versus taxable compounding in advertising and sales literature; shorten and simplify existing provisions regarding product identification, liquidity, and guarantee claims; address developments in variable insurance products and the manner in which they are advertised, particularly with regard to riders and hypothetical illustrations; and, require that all marketing materials clearly identify the type of variable product that is being discussed. The proposal is summarized below.

We have scheduled a conference call for Wednesday, August 20, at 2 p.m. Eastern Time to discuss the FINRA proposal. The dial-in number for the conference call will be 1-888-469-1350 and the passcode for the call will be 47877. If you plan to participate on the call, please contact Jennifer Odom by email at jodom@ici.org or by phone at 202-326-5833.

Product Identification, Liquidity, Guarantee Claims and Riders

The Proposal would shorten and simplify existing provisions regarding product identification, liquidity, and guarantee claims, and would impose new requirements to address the use of riders in variable insurance products. In particular, the Proposal would require that all communications clearly identify the type of product discussed and would prohibit communications from representing or implying that a variable insurance product is a mutual fund. It would prohibit communications from falsely implying that variable insurance products are short-term, liquid investments, and would require any marketing or sales presentation regarding access to account values to be balanced by a description of the potential effect of all charges, penalties, or tax consequences resulting from a redemption or surrender.

In addition, the Proposal would prohibit member firms from exaggerating the relative benefits of a guarantee, or an insurance company's financial strength, or credit rating. Any discussion of a guarantee would have to disclose all material applicable limitations or qualifications. Further, communications regarding guarantees would have to disclose that the investment return and principal value of an investment option are not guaranteed and will fluctuate. Communications that discuss the circumstances under which a guarantee or rider will benefit the customer would have to be fair and balanced considering the circumstances under which the guarantee or rider will not benefit the customer. The Proposal also would require discussions about riders to explain the nature of the rider, its costs and limitations, and the fact that it is an optional feature of the contract.

Qualified Plans

The Proposal would address concerns with recommendations to purchase variable insurance products through a tax-qualified account. It would retain the existing FINRA guidance that the purchase of a variable annuity through a tax-qualified account should be recommended only when other benefits, such as lifetime income payments, family protection through the death benefit, or guaranteed fees, support the recommendation. In addition, the Proposal would prohibit any communications concerning a variable insurance product offered through a tax-qualified retirement plan from indicating that the tax-deferred treatment of earnings is available only through investment in the contract. It would require disclosure that the contract does not provide any additional tax-deferred treatment of earnings beyond the treatment of earnings provided by the retirement plan.

Historical Performance

The Proposal would permit the use of historical performance in communications with the public subject to various conditions. For example, historical performance information in communications regarding variable life insurance policies would be required to reflect, at a minimum, the deduction of all fees and charges applicable at the investment option level. In addition, the Proposal would require that investors be encouraged to obtain a personalized hypothetical illustration to reflect an individual investor's characteristics and preferences. Information regarding performance of an investment option that occurred during the period prior to its availability through the separate account of a variable insurance product also would be permitted, provided it was accompanied by specified

information, such as identification of the period during which the performance occurred.

Likewise, the Proposal would permit the presentation of combined information of multiple investment options so long as the individual performance of each investment option included within the combined performance was provided too. It also would allow the presentation of illustrations based on the historical performance of individual investment options or combinations of investment options using assumed dollar investment. These illustrations would have to present dollar values that are net free of fees and to explain that the illustration is not intended to predict or project future performance.

Illustrations Based on Assumed Rates of Return

The Proposal would allow for the presentation of hypothetical illustrations based on assumed rates of return (rather than historical performance) to demonstrate the way a variable insurance product operates. In each of the permitted scenarios, various conditions would have to be met. Investment results could be shown, for example, based on an assumed positive gross annual rate of return of up to 10 percent, so long as the results reflected the deduction of the maximum guaranteed charges. Alternatively, the Proposal would permit the presentation of an illustration based on multiple assumed rates of return that vary year by year, provided the rates of return were based on the actual performance of a broad-based securities market index for the period covered by the illustration; “random rate” illustrations would be prohibited. As with historical performance illustrations, assumed-rate illustrations would have to explain prominently that the illustration is hypothetical and does not project or predict future performance. They also would have to clearly label and define all values and disclose the gross and net rates of return depicted.

Comparative Illustrations

The proposal would set forth certain requirements for marketing and sales communications concerning comparative illustrations of the mathematical principle of tax-deferred versus taxable compounding. In particular, an illustration would have to use identical amounts and identical assumed gross rates of return for the taxable and tax-deferred investments. The illustration also would have to include certain disclosures, as applicable. It would have to disclose the extent to which tax rates on capital gains and dividends would affect the taxable investment’s return and state its underlying assumptions and the potential impact resulting from federal or state tax penalties for early withdrawals. The illustration also would have to state that an investor should consider his or her current and anticipated investment horizon and income tax bracket when making an investment decision, as it may not reflect these factors.

Heather L. Traeger
Assistant Counsel

endnotes

[\[1\]](#) See Variable Insurance Products, “FINRA Requests Comments on Proposed New Rules Governing Communications About Variable Insurance Products,” FINRA Regulatory Notice

08-39, July 2008 ("Proposal"). The Proposal is available on FINRA's website at: <http://www.finra.org/RulesRegulation/NoticestoMembers/2008Notices/P038982>. Comments on the Proposal are due September 30, 2008.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.