

**MEMO# 23974**

November 24, 2009

## **FINRA Files Proposal With SEC Regarding Public Communications for Variable Insurance Products**

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TO: VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 22-09    RE: FINRA FILES  
PROPOSAL WITH SEC REGARDING PUBLIC COMMUNICATIONS FOR VARIABLE INSURANCE  
PRODUCTS

The Financial Industry Regulatory Authority (“FINRA”) has filed a proposed rule change with the Securities and Exchange Commission (“SEC”) to adopt Rule 2211 that would modify, simplify, and codify the existing guidance governing communications with the public about variable insurance products, other than institutional sales material. [\[1\]](#) Specifically, in an attempt to portray a balanced picture of variable insurance products to the public, the proposal would address product identification issues, guarantee claims and riders, historical performance, and illustrations based on assumed rates of return. The proposal notes that each firm should tailor its disclosure based on the features of the product being promoted.

Prior to filing the proposal with the SEC, FINRA requested public comment on its proposed new rules to govern communications about variable insurance products. [\[2\]](#) On September 30, 2008, the Institute submitted a comment letter to FINRA recommending certain modifications and clarifications to FINRA’s proposed new rules. [\[3\]](#) The proposal filed with the SEC addresses a number of the Institute’s recommendations to FINRA. The highlights of the proposal are summarized below.

## **Product Identification**

The proposal would prohibit communications from representing or implying that variable insurance products are mutual funds, despite the Institute's recommendation that firms be permitted to describe underlying investment options of variable insurance products as mutual funds.

## **Variable Annuity Performance and Variable Life Insurance Policy Performance**

The proposal would permit firms to present the historical performance of registered variable annuities in accordance with the requirements of the securities laws. It also would require communications that present variable life insurance policy performance to urge investors to obtain a personalized hypothetical illustration. In response to the Institute's request, FINRA has provided clarification that use of variable life insurance policy performance would not need to be accompanied by a statutory prospectus.

## **Pre-Dated Performance**

The proposal would set forth requirements, subject to certain conditions, for pre-dated performance of a fund before it became available as an investment option through a separate account. [\[4\]](#) Such information would aid investors interested in assessing the performance of an underlying fund from its inception and not simply from the date of its inclusion as an investment option through a variable insurance contract. In presenting pre-dated performance information, the proposal would require the presentation of "standardized" performance under Rule 482 of the Securities Act of 1933 ("Securities Act").

In response to comments, the proposal would not require the deduction of maximum guaranteed charges from pre-dated performance. FINRA also eliminated the provision that pre-dated performance be allowed only if there has been no "significant change" to the investment objectives, strategies, or policies of the investment option during the period for which performance is shown. In addition, so long as SEC rules and interpretations permit a feeder fund to incorporate a master fund's prior track record, the proposal would not prohibit the use of the feeder fund performance that is not available as an investment option through the separate account. Finally, the proposal would only apply to registered variable annuity pre-dated performance, and would require only that the communication identify the period during which the pre-dated performance occurred.

## **Illustrations Based on Assumed Rates of Return**

The proposal would outline a series of requirements for variable insurance product illustrations that employ an assumed-rate of return. For example, the proposal would require an illustration to show results that are net of a product's maximum guaranteed charges, despite commenters' recommendation to employ a product's current charges instead. The proposal would, however, allow illustrations to show results that are net of the current charges if accompanied by results that are net of the maximum guaranteed

charges. The proposal would not require firms to deliver a variable insurance product prospectus with an assumed-rate illustration.

With respect to single assumed rates of return, the proposal would cap the maximum positive assumed rate of return that an illustration may employ at 10 percent per year. In response to the Institute's recommendation that FINRA monitor market conditions going forward to see if further changes are necessary, FINRA stated its belief that historical trends indicate that a 10 percent cap is sufficiently high to show how a product may operate in the future. The proposal would require positive assumed rates of return to be reasonable in light of the investment objectives of any particular investment option or options that are named in the illustration instead of "reasonable considering market conditions and the available investment options." It also would permit an illustration to employ a negative assumed gross rate of return provided it was accompanied by illustrations showing a positive gross rate of return between 5 and 10 percent per year. [\[5\]](#)

For multiple assumed rates of return, the proposal would permit assumed-rate illustrations that employ the returns of a broad-based securities market index. To qualify, an index would need to be capable of being used for comparison to an investment company's own performance in its prospectus, and would satisfy the definition in SEC Form N-1A. The performance of a qualifying broad-based securities market index would need to be current as of at least the most recent calendar year ended prior to the date of use of the illustration. "Random-rate" illustrations would no longer be allowed.

The proposal would not require delivery of an arithmetic average illustration with a weighted average illustration that complied with the proposal's requirements.

## **Combined Historical Performance**

The proposal would permit the presentation of the combined performance of multiple investment options reflecting a static allocation. It would not require that such information be "standardized" performance for purposes of Rule 482 under the Securities Act.

## **Historical Performance Illustrations**

The proposal would set forth requirements for an illustration that uses the historical performance of one or more investment options. It would require for variable annuity historical illustrations the deduction of all expenses required to be deducted under Rule 482 instead of the previously proposed requirement to net out maximum guaranteed charges. The proposal would not require such illustrations to present year-by-year account values in tabular or bar-chart format. FINRA declined to adopt the Institute's suggestion that the proposal define the term "illustration" because of its belief that what qualifies as an illustration will always be based on the individual facts and circumstances.

## Guarantee Claims and Riders

The proposal would require communications that discuss a guarantee or rider to refrain from exaggerating the relative benefits of a guarantee or an insurance company's financial strength or credit rating. It would require a balanced discussion of costs and limitations of the guarantee or rider, and if applicable, that the guarantee or rider is an optional feature of the contract that may not benefit all investors. This discussion would be in lieu of FINRA's original proposed requirement to disclose all material applicable limitations and qualifications every time a guarantee is mentioned. Thus, it would not be necessary to reference an insurance company's possible failure, as the proposal would already prohibit exaggeration of an insurance company's financial strength and rating. In addition, in response to the Institute's concern, the proposal would not require that communications that discussed the circumstances under which a guarantee or rider will benefit the customer to be fair and balanced considering the circumstances under which the guarantee or rider will not benefit the customer.

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### endnotes

[1] See Proposed Rule Change to Adopt FINRA Rule 2211 Communications with the Public About Variable Insurance Products, FINRA 2009-70, October 20, 2009 ("Proposal"), available at: <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p120247.pdf>. The SEC has not yet published the Proposal.

[2] See FINRA Regulatory Notice 08-39 (July 2008), available at: <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p038981.pdf>.

[3] See Letter from Heather Traeger, Assistant Counsel, Investment Company Institute, to Marcia E. Asquith, Office of the Corporate Secretary, Financial Industry Regulatory Authority, dated September 30, 2008.

[4] This provision of the proposal would not apply to the performance of an investment option in variable life insurance sales material.

[5] The illustration would not need to include illustrations showing results based on a zero percent gross rate of return.