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August 12, 2005

Barbara Z. Sweeney
Office of Corporate Secretary
NASD 1735 K Street, NW
Washington, D.C. 20006-1500

RE: NASD Notice to Members 05-40; Proposed Rule 2311.

Dear Ms. Sweeney:

The American Council of Life Insurers (ACLI) respectfully submits input on NASD Notice to Members 05-40 (June 2005) that invited comment on proposed restrictions on non-cash compensation and sales contests in Rule 2311.

The ACLI is a national trade association with 356 members representing 80 percent of all United States life insurance companies as measured by total assets, and reflecting 84 percent of total annuity considerations and 78% of total insurance premiums. Many of our member companies offer and distribute variable annuities and variable life insurance directly or through affiliated and independent broker-dealers. Over 50% of the NASD's 661,780 registered representatives work for broker-dealers affiliated with life insurance companies. The initiative would have a significant impact on our industry.

According to the Notice to Members, Rule 2311 would extend to all securities the current prohibition on non-cash compensation in several categories of securities such as mutual fund and variable contracts. The rule would also eliminate a current exception in Rule 2820(g) for product-specific sales contests, but would allow sales contests based on a salesperson's aggregate sales for all securities. Further, the proposal would eliminate a current provision in Rule 2820(g) permitting third parties to contribute to a non-cash arrangement between a broker-dealer and its salespersons.

ACLI provided extensive input between 1988 and 1998 on Rule 2820(g) governing cash and non-cash compensation in the sale of variable life insurance and variable annuities. The proposal has a direct impact on Rule 2820(g) and the

practices and compliance procedures broker-dealers implemented in response to the rule.

The life insurance industry has carefully scrutinized the proposed rule. The initiative has elicited a variety of concerns from life insurers, as evidenced by several letters of comment filed with the NASD. ACLI's Committee on Securities Regulation evaluated the proposal and its impact on variable product distributors and manufacturers. Some observers have questioned procedural aspects of the proposal, while others have expressed significant reservations concerning mechanics of the proposal and practical ambiguities. At this juncture of the rulemaking process, we offer several limited comments to supplement other input offered by life insurers. At future stages of the rulemaking, ACLI may choose to highlight additional issues.

Procedural Issues

Self-regulatory rulemaking should thoroughly explain the need for new rules, practices, or interpretations supported by quantifiable rationale. The nexus between regulatory solutions and regulatory need should be clearly stated. Burdens of new regulations must be carefully balanced against the regulatory goals of each proposal. Every self-regulatory initiative should include a meaningful economic and competitive impact statement. Each rule should exhibit clear drafting to avoid interpretive ambiguity, and should be fully explained in the adopting Notice to Members. These essential approaches to rulemaking ensure that new rules and responsive enterprise-wide compliance procedures are appropriate.

The life insurance industry provided significant input to NASD as it developed Rule 2820(g) concerning cash and non-cash compensation standards through *eight* proposals spanning a *ten year* period.¹ The long hiatus between initial proposal and final adoption reflects the complexity of this issue and the deliberative rule governing it. This rule's administrative history established a rich source of interpretive guidance upon which broker-dealers relied since 1998.

Following adoption of the rule, broker-dealers distributing variable products implemented enterprise-wide compliance procedures and supervisory practices to

¹ See NASD NTM 88-17 (March 1998); NASD NTM 89-51 (July 1989); NASD NTM 91-25 (May 1991); NASD NTM 91-68 (May 1991); NASD NTM 94-67 (Oct. 1994); NASD NTM 95-56 (Sept 1995); NASD NTM 96-52 (August 1996); NASD NTM 97-50 (Aug. 1997); NASD NTM 98-75 (Sept. 1998). See also Wilkerson, *Recent Regulatory Developments Affecting Insurance Affiliated Broker-Dealers*, ALI-ABA conference on Life Insurance Company Products (Nov 1991) at 229; Krawczyk, *Recent Developments of Interest to Sellers of Variable Insurance Products*, ALI-ABA Conference on Life Insurance Company Products (Nov 1998) at 257.

fulfill the rule's new mandates. Adjustment to any new NASD rule is a significant undertaking, and involves considerable expense and commitment to training, revised compliance procedures, supervision, and system changes. Elimination of currently authorized practices under NASD rules also triggers similar considerations. Rulemaking should always be well-reasoned and clearly substantiated in the interest of administrative fairness and consumer protection.

Several aspects of proposed Rule 2311 fail these standards. The proposal would revise practices that evolved during the ten-year development of Rule 2820(g). Several aspects of Rule 2820(g) would be eliminated in the proposal with little analysis or substantiation. No estimate of the economic or competitive consequences of these rule changes appears in the proposal. The regulatory goals supporting the eliminations have not been identified, and no nexus between the rule's purpose and the solution is apparent. The proposal does not evaluate the rule's economic and structural impact on broker-dealers' existing enterprise-wide compliance procedures, training, systems or supervision. Several observers have noted that the proposal contains nebulous ambiguities and may inflict significant interpretive burdens. These collective factors are unacceptable in self-regulatory rulemaking.

Substantive Issues

Applying NASD non-cash compensation standards to all securities transactions creates a balanced regulatory structure and enhanced consumer protection. Implementing non-cash compensation rules for all securities sales rectifies the NASD's historically selective application of these standards to variable products, mutual funds, and a few other securities. It is commendable that the NASD is endeavoring to apply its rules equitably across the securities industry. This is good for consumers and the NASD alike.

Broker-dealers distributing variable life insurance and variable annuities implemented structural and systems changes to fulfill the NASD's cash and non-cash compensation standards since they were adopted in 1998. Uniquely, variable product compensation occurs within both a securities industry and insurance industry context. Any revisions to Rule 2820(g), therefore, need carefully managed coordination to prevent unwarranted disruption to established and appropriate practices.

In addition to extending current cash and non-cash compensation requirements to all securities sales, the proposal would revise several aspects of Rule 2820(g). The proposal would eliminate the current exception in Rule 2820(g) for product-specific sales contests. The initiative would also eliminate a provision currently permitting other parties to contribute to non-cash compensation arrangements

between a broker-dealer and its registered representatives, and would eliminate a provision permitting contributions by a broker-dealer to a non-cash compensation arrangements of other entities so long as the arrangements fulfill total production and equal weighting standards. Termination of these currently permitted practices has been a focus of discussion by variable contract distributors and manufacturers.

Weighted Sales Contests

It is important that the NASD continue to allow broker-dealers flexibility in weighting different types of securities in sales compensation programs, provided that the broker-dealer does not create an inappropriate incentive to favor a particular type of security. For example, the NASD recognized in Notice to Members 98-75 that there are substantial differences in the design, purpose, cost structure, commission payouts, and target audience for variable life insurance relative to variable annuities. As a result of these substantial differences, it is difficult to imagine a specific measurement (such as a percentage of premium or commissions) a broker-dealer could use to equally-weight the sale of variable life insurance with other types of securities in a fair or meaningful fashion.

In solution, we suggest that the proposed rule allow broker-dealers flexibility to use different measurements in applying credit for the sale of substantially different types of securities, provided that (i) the broker-dealer uses the same measurement within each type of security and (ii) the measurement the broker-dealer uses for any particular type of security does not create an inappropriate incentive for registered representatives to favor the sale of that particular type of security. For example, variable life insurance is a substantially different product relative to mutual funds. In addition, the amount a customer initially invests in a mutual fund is generally greater than the premium a customer initially transmits on a variable life insurance policy. As a result, a broker-dealer could give a salesperson a higher percentage of credit for a dollar of life insurance premium relative to a dollar invested in a mutual fund without creating an incentive for the representative to inappropriately favor the sale of variable life insurance.

Contributions to Non-cash Arrangements

The NASD should permit broker-dealers and third parties to contribute to non-cash compensation arrangements, as Rule 2820(g) currently does. Proposed Rule 2311 sufficiently protects customers by eliminating inappropriate non-cash incentives. As a result, barring contributions from other companies to a broker-dealer's non-cash compensation arrangements will increase broker-dealers' operating and training costs without providing any additional protection for customers.

Contributions allow broker-dealers to remain competitive by sharing costs with other companies that benefit from the broker-dealer's non-cash compensation arrangements. For example, registered representatives of insurance-affiliated broker-dealers are typically also producing agents of the affiliated insurance company. As a result, the affiliated insurance company often co-sponsors or contributes to the affiliated broker-dealer's non-cash compensation arrangements, such as sales incentive meetings or recognition dinners. These contributions are generally used towards non-cash compensation related to the sale of proprietary fixed insurance products and both proprietary and non-proprietary variable insurance products. In addition, broker-dealers accept contributions from unaffiliated companies that offer mutual funds or other securities products to customers through the broker-dealer. These companies benefit from the broker-dealer's non-cash compensation arrangements and should be allowed to support the costs of the broker-dealer's non-cash compensation arrangements, since the arrangements do not create inappropriate incentives.

Clarifying the Rule's Treatment of Commissions

Ambiguous language in proposed Rule 2311 may unintentionally create conflicts with broker-dealers' internal compensations programs. Even though NTM 05-40 cites the NASD's intent not to interfere with broker-dealers' traditional cash compensation programs, the terms in the proposal create an ambiguity. The rule, if adopted, needs to clearly delineate between traditional compensation programs and sales contests. For example, if broker-dealers incorporate tiered commissions schedules for product sales (such as stair-stepped commission increases relative to increased production), the rule could theoretically construe tiered commission schedules as a prohibited sales contest. If the rule is adopted, it should unequivocally exclude fixed commission schedules from the sales contest definition.

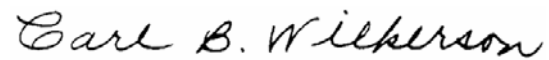
Conclusion

Propose Rule 2311 appropriately applies cash and non-cash compensation standards to all securities sales and reflects a balanced application of NASD rules that appropriately protects all consumers. If current Rule 2820 is subsumed in Rule 2311, the proposed rule needs substantial modification to incorporate practices that are permitted in Rule 2820 following its ten years of development. Broker-dealers have implemented enterprise-wide compliance procedures in reliance on Rule 2820 that should be retained. There has been no suggestion that the practices allowed under Rule 2820 in the distribution of variable contracts have been the source of problems. In several respects, the language of the rule is imprecise and needs careful clarification to achieve its purpose.

In all rulemaking, it is important for the NASD to fully analyze the economic and competitive impact of proposals, and to clearly quantify regulatory needs and burdens. In this way, rules will be more fully and equitably useful.

We greatly appreciate your attention to our views. If any questions develop, please contact us.

Sincerely,

A handwritten signature in cursive script that reads "Carl B. Wilkerson".

Carl B. Wilkerson