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Dear Ms. Asquith:

I appreciate the opportunity to comment on FINRA's regulatory notice 08-39, "Proposed New Rules Governing Communications About Variable Insurance Products". Among other duties, the New York State Insurance Department (NYSID) is responsible for regulating the content, form, illustration, advertisement and market conduct aspects of variable insurance products delivered in New York. We have a significant body of law and experience relating to communications with the public on insurance products including variable insurance products.

FINRA's requirements are directed to member security firms and their representatives while New York Law is primarily directed to insurers. Nevertheless, the objectives of FINRA and the NYSID, to protect consumers and ensure fair markets, are aligned. I hope you find our comments useful.

Comments

We recommend adding the underlined to IM_2210_1(3) as follows:

(3) Member communications must be clear. A statement made in an unclear manner can cause a misunderstanding. A complex or overly technical explanation may be more confusing than too little information. Communications must be truthful in fact or in implication. The format and content of a communication must be sufficiently complete and clear so that it is neither misleading nor deceptive, nor has the capacity or tendency to mislead or deceive. Statements made should not cloud or misdirect the consideration of the purchaser. The use of technical insurance terminology should be held to a minimum and be appropriate within the context of the communication.

We recommend adding the underlined to proposed IM-2210-1(5)(A)

(A) In advertisements and sales literature, references to tax-free or tax exempt income or a synonymous term must indicate which income taxes apply, or which do not, unless income is free from all applicable taxes. For example, if income from an investment company investing in municipal bonds is subject to state or local income taxes, this fact must be stated, or the illustration must otherwise make it clear that income is free only from federal income tax.

The requirement in proposed IM-2210-1(5)(B)(ii) that the tax rate be identified should also be included in proposed IM-2210-1(5)(B)(iii). We recommend the option to use state income tax rates be extended to include city, county and similar income tax rates in IM-2210-1(5)(B)(iii).

We recommend the following wording for proposed IM-2210-1(5)(B)(iv)

(iv) Tax rates used in an illustration that is intended for a target audience must reasonably reflect the tax bracket or brackets of the target audience as well as the tax character of capital gains and ordinary income. Thus, for example, if money that is withdrawn from a tax-deferred account is taxed as ordinary income, the illustration could not employ a capital gains income tax rate.

We recommend replacing “its” in proposed IM-2210-1(5)(B)(vii)(b) with “the illustration’s”.

We recommend amending proposed IM-2210-2(a)(2) as follows:

(2) “Cost of insurance” means the actual mortality charges deducted according to the terms of the contract from premiums, account values or taken as a reduction in investment credits.

We recommend adding the underlined to IM-2210-2(a)(6) as follows:

(6) “Rider” means an additional provision to a contract that adds or excludes coverage at an identifiable cost.

It is not clear that a “Personalized hypothetical illustration” as defined in proposed IM-2210-2(a)(5) meets the definition of a “communication with the public” in 2110(a). For clarity, we recommend a statement in proposed IM-2210_2 that clearly states a “Personalized hypothetical illustration” is considered sales literature under 2110(a)(2).

In proposed IM-2210_2(c) on liquidity, we recommend the description of potential effects include effects on contract benefits. For example, a withdrawal may terminate a no-lapse provision. Similarly, we recommend replacing death benefits in the last sentence in this section with contract benefits.

In proposed IM-2210_2(d)(1), it is not clear if “limitations and qualifications” refers to guarantees or financial strength ratings. We recommend specifically mentioning the special need for clarity when a guaranteed value is not available in cash (e.g., only available to determine guaranteed minimum income or withdrawal benefits). We recommend adding the underlined to proposed IM-2210_2(d)(1).

(1) Communications may not exaggerate the relative benefits of a guarantee, or the insurance company’s financial strength or rating. Discussions of guarantees must disclose all material applicable limitations or qualifications related to the guarantees. When a communication includes a guaranteed amount, benefit base or similar contract accumulation value that is not fully available in cash, the communication must clearly disclose that such accumulation is not available in cash or if applicable the restrictions and reductions to receiving such value in cash.

In proposed IM-2210_2(d)(2), we recommend modifications to handle the case when a variable product has a principal guarantee or minimum level of guaranteed return. We recommend proposed IM-2210_2(d)(2) be reworded as follows.

(2) “Communications must disclose the extent to which the investment return and principal value of the investment options are not guaranteed and will fluctuate.”

The NYSID is very concerned that historic performance can be misleading. Consumers may not consider how cyclical trends, changes in fund composition over time, changes in fund strategy over time and survivorship bias impact historical returns. Consumers may be too willing to allocate resources to various investments based on past performance. We recommend adding the following to IM-2110-2(f):

(7) A communication of historic performance must include the following notice:
Historic performance may result from trends in interest rates, the ratio of prices to earnings, tax rates and other economic variables. Such trends may not continue into the future. Other factors, such as investment strategy, may change over time. For these and other reasons historical performance may be a poor indicator of future performance.

New York does not allow the projection of historical performance into the future in any variable annuity illustration. In addition, Part 50.8 of New York regulation 47 places a cap of 8% on the rate that may be used in a variable annuity illustration. Part 50.8 reads in part as follows:

11 NYCRR 50.8 Illustrations of benefits payable under separate account annuity contracts

Illustrations of benefits payable under any separate account annuity contract, which are incorporated in or attached to any such contract or are utilized in advertising or sales material relating to any such contract, shall not include projections of past investment experience into the future or attempted predictions of future investment experience; provided that nothing herein contained shall prohibit the use of hypothetical rates of investment return, clearly designated as such, to illustrate possible levels of variable annuity payments, if the use of such hypothetical rates is not in conflict with applicable requirements of the Securities and Exchange Commission. ... Except as approved by the superintendent, no hypothetical rate of investment return in excess of eight percent may be used in such illustrations.

We recommend adding the following to the end of the sentence in proposed IM2210_2(f)(3)(C), “and the investment option was managed according to such objectives, policies and strategies over the period for which performance is presented.”

We recommend adding the following to IM2210_2(f)(4)(B),

(iv) whether or not funds are rebalanced for the period of combined experience. If funds are rebalanced the method and frequency of rebalancing is described.

In regards to proposed IM-2210_2(g), the NYSID has noticed various interpretations of the term “gross rate”. We recommend a definition of gross rate be added to the proposed IM-2210-2(a) as follows:

“gross rate” means the investment yield per dollar invested before fund level, separate account level and contract level deductions and charges.

This gross rate is not net of fund level expense and hence differs from the yield in Rule 482. This is not inconsistent since Rule 482 addresses historical returns and IM-2210_2(g) addresses hypothetical returns. A gross rate defined in this manner seems appropriate to establish an equal playing field between high expense and low expense funds with similar investment policies.

We recommend changing proposed IM_2210_2(g)(2&3) to lower 10% to 8% and changing proposed IM_2210_2(g)(2) to allow a cumulative test so periods of significant volatility can be illustrated. We recommend wording for proposed IM_2210_2(g)(2) as follows:

At the member’s option, the illustration shows investment results that at any time are not in excess of the cumulative investment result based on a gross annual rate of return of 8% and the deduction of the maximum guaranteed charges. Assumed rates of return must be reasonable considering market conditions and the available investment options.

This would allow a hypothetical illustration of 4% in the first year followed by 12% in the second year, but not allow a hypothetical illustration of 12% in the first year followed by 4% in the second year.

We don’t see the need for proposed IM_2210_2(g)(4). This has all the difficulty of trying to understand the cyclical trends over the period of historic performance plus the additional problem of understanding basis risk from a lack of correlation. In the absence of a compelling need, we recommend deleting IM_2210_2(g)(4).

We recommend replacing “death benefit” in IM_2210_2(g)(8) with “contract benefits”.

The third paragraph of IM-2210-(6)(a) indicates the investment analysis tool under proposed IM_2210_2(i) is subject to the gross rate of return limitation in proposed IM_2210_2(g). If IM_2210_2(i) is not subject to IM_2210_2(g) this would severely undercut the intent of IM_2210_2(g). We recommend a clear statement that any investment analysis tool must comply with IM_2210_2(g).

Sincerely,

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State of New York Insurance Department