

October 29, 2007

The Honorable Joe Coto
Chairman, Assembly Committee on Insurance
State Capitol
P.O. Box 942849
Sacramento, CA 94249-0106

RE: October 30 Interim Insurance Committee Hearing

Dear Chairman Coto:

The Securities Industry and Financial Markets Association (SIFMA)¹ appreciates the opportunity to express its views on state regulation of life insurance annuity sales to seniors. We applaud your committee for the substantial attention you have brought to the annuity issue over the last several years. Annuity products - particularly deferred variable annuities – are increasingly popular investment options for persons of all ages. This is due, at least in part, to the tax-deferred savings accumulation and lifetime income stream that these products can provide. Responsible sales practices and respectful and appropriate client treatment are critical both to the investor’s financial well-being and to the well-being of our industry.

As you undoubtedly know, broker-dealers and their registered representatives are already subject to general suitability requirements and “Know Your Customer” requirements under NASD (now part of the Financial Industry Regulatory Authority or FINRA) Rule 2310, a copy of which is attached. Under this rule, a FINRA member or its registered representative must have “reasonable grounds for believing that the recommendation is suitable for such customer” and is required to “make reasonable efforts” to obtain information concerning the customer’s financial status, tax status, investment objectives, and “such other information used or considered to be reasonable. . . .” These suitability requirements apply to all customers and not just seniors. Those broker-dealers and their registered representatives that do not make reasonable suitability assessments prior to a product sale are subject to administrative actions, fines, and restitution.

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members’ interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

In addition, FINRA recently finalized Rule 2821, a copy of which is attached, which spells out in great detail appropriate deferred variable annuity disclosure, sales practices and supervisory procedures. The rule explicitly states that Rule 2310 applies to deferred variable annuities; it also substantially expands the list of information that the broker-dealer and/or registered representative must reasonably try to obtain before selling a deferred variable annuity product to a customer. For example, there must be a reasonable basis to believe that the customer is aware of various features of deferred variable annuities, including the potential surrender period and surrender charge, age-based tax penalties for selling the annuity “early,” investment advisory fees, mortality and expense fees, the significance of riders, the insurance and investment components of deferred variable annuities, and market risk. In addition, the broker-dealer/registered representative must reasonably believe that “the customer would benefit from certain features of deferred variable annuities, such as tax deferred growth, annuitization, or a death or living benefit.” Furthermore, to help ensure that the product is appropriate for the buyer’s needs, a registered representative must, before making any recommendation, make reasonable efforts to obtain a wide range of information “concerning the customer’s age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets, liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable in making recommendations to customers.”

Moreover, the new rule ensures that there is additional oversight and review of any variable annuities transaction. This is because all sales must now be reviewed and approved by a principal at the broker-dealer before it is transmitted to the issuing insurance company for processing. The sale cannot be approved unless the principal agrees that there is a reasonable basis to believe that the transaction is suitable. Furthermore, firms must establish written supervisory procedures, implement surveillance procedures to identify registered representatives whose practices are questionable, and adopt policies and procedures to implement corrective measures, where necessary.

FINRA’s new rule on variable annuities, which should be implemented shortly, applies to all variable annuity customers and not just senior investors. FINRA does, however, recognize that age is often a factor in determining suitability and includes age as one of the pieces of information registered representatives should make reasonable efforts to get from the customer. FINRA also seeks to protect seniors through investor education, member education and outreach, exams and enforcement. In addition, FINRA recently released Regulatory Notice 07-43 (September 2007), a copy of which is attached, which specifically addresses the suitability of recommendations to older investors and communications aimed at them. With respect to suitability, FINRA notes that:

Although [Rule 2310] does not explicitly refer to a customer’s age or life stage, both are important factors to consider in performing a suitability analysis. As investors age, their investment time horizons, goals, risk tolerance and tax status may change. Liquidity often takes on added importance. And, depending on their particular circumstances, seniors and retirees may have less tolerance for certain types of risk than other investors. . . . Therefore, firms cannot adequately assess

the suitability of a product or transaction for a particular customer without making reasonable efforts to obtain information about the customer's age, life stage and liquidity needs.

With Rule 2310, Rule 2821 and Regulatory Notice 07-43 in place, we strongly believe that an additional layer of state regulation, at least as it relates to broker-dealers, is unnecessary. If, however, something like SB 573 is to be adopted at the state level, we respectfully request that you impose no new requirements on broker-dealers and their registered representatives. Among other things, if SB 573 is the basis for any future legislation, this would mean striking Section (5) (4), which requires that broker-dealers - and perhaps even individual brokers - submit their suitability standards and related consumer questionnaires to the insurer for review and approval. This provision adds little to investor protection while imposing additional time-consuming layers of bureaucracy. Moreover, because many of the forms and questionnaires are unique to each broker-dealer, we are concerned that the new requirements could result in wide dissemination of firm proprietary information.

While you suggested that each insurer could create and mandate its own suitability form, this would create additional problems. Broker-dealers often have relationships with a number of insurers. It would be unduly burdensome to require broker-dealers and their registered representatives to use a different suitability assessment for each insurer. Furthermore, a broker-dealer could determine that an insurer's form does not satisfy the broker-dealer's suitability obligations under NASD Rules 2310 and 2821; thus, more than one suitability form could be required for a single sale. Finally, even if a workable form could be developed, registered representatives may be reluctant to fill out and send to outside organizations forms that provided detailed and potentially confidential information about their customers.

We did very much appreciate the language in 5(e) (located in a recent version of the bill on page 7, lines 9-12) which tried to get at the issue by stating that "compliance with National Association of Securities Dealers Conduct Rules pertaining to suitability shall satisfy the requirements under this section for the recommendation of variable annuities." This is a very good first step. We, however, are concerned that, while the language creates a safe harbor for broker-dealers, it does not appear to obviate the need for broker-dealers to nonetheless submit their suitability standards and related consumer questionnaires to the insurer for review and approval. We therefore recommend that you eliminate the requirement that suitability standards and related consumer questionnaires be submitted to the insurer for review and approval.

We thank you for your continued work on this issue, and we look forward to working with you to help advance responsible sales practices without unduly restricting or impeding legitimate business activity.

If your staff has any questions, please contact myself at 212-720-0611 or our California lobbyist Jim Bruner at 916-329-7901.

Sincerely,

A handwritten signature in black ink that reads "Kim Chamberlain". The signature is written in a cursive, flowing style.

Kim Chamberlain
Managing Director and Counsel
State Government Affairs

Attachments