Regulatory Notice 08-39

Variable Insurance Products

FINRA Requests Comments on Proposed New Rules Governing Communications About Variable Insurance Products

Comment Period Expires: September 30, 2008

Executive Summary

FINRA requests comment on proposed changes to guidelines on illustrations of tax-deferred versus taxable compounding in advertising and sales literature (NASD Interpretive Material 2210-1) and communications with the public about variable life insurance and variable annuities (NASD Interpretive Material 2210-2). The proposal would:

- shorten and simplify existing provisions regarding product identification, liquidity and guarantee claims;
- consolidate previous FINRA staff guidance concerning variable insurance product communications;
- address changes in variable insurance products and the manner in which they are advertised, particularly with regard to riders, hypothetical illustrations and investment analysis tools; and
- codify FINRA staff guidance concerning comparative illustrations of the mathematical principle of tax-deferred versus taxable compounding.

Questions concerning this *Notice* should be directed to Joseph P. Savage, Vice President and Counsel, Investment Companies Regulation, at (240) 386-4534; or Thomas A. Pappas, Vice President and Director, Advertising Regulation, at (240) 386-4553.

FINRA™

Financial Industry Regulatory Authority

July 2008

Notice Type

- Request for Comment

Suggested Routing

- Advertising
- Legal & Compliance
- Operations
- Senior Management

Key Topic(s)

- Communications with the Public
- Supervision
- Variable Insurance Products

Referenced Rules & Notices

- NASD Rule 2210
- NASD IM-2210-1
- NASD IM-2210-2
- NASD IM-2210-3
- NASD IM-2210-6
- NTM 99-35

Action Requested

FINRA encourages all interested parties to comment on the proposed changes. Comments must be received by September 30, 2008. Member firms and other interested parties can submit their comments by:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

  Marcia E. Asquith
  Office of the Corporate Secretary
  FINRA
  1735 K Street, NW
  Washington, DC 20006-1500

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposals.

Important Notes: The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.[1]

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.[2]

Background & Discussion

A. Background

FINRA proposes to update and consolidate the rules governing member firm communications with the public about variable insurance products. The core of these rules is found in NASD Interpretive Material 2210-2 (Communications with the Public About Variable Life Insurance and Variable Annuities) (Guidelines). FINRA adopted the Guidelines in 1993 and has issued related interpretations in various publications since then. Through the review of communications submitted by firms to FINRA's advertising filings program, the FINRA Advertising Regulation Department staff has developed additional interpretations of the Guidelines.

FINRA proposes to modernize the Guidelines in a number of respects. Certain of its provisions would be shortened and simplified. Other changes would address areas that have seen significant changes since the Guidelines were first issued, particularly with respect to the use of riders and hypothetical illustrations. The proposal also would codify previous FINRA guidance concerning the use of comparative illustrations of the mathematical principles of tax-deferred versus taxable compounding in communications.

B. Definitions

Proposed IM-2210-2 would contain for the first time a separate paragraph of defined terms. The purpose of this section is to clarify the meaning of certain terms used throughout the proposed rule. The definitions section is not intended to define insurance-related terms in other contexts beyond the scope of this rule.

C. Product Identification and Liquidity

Proposed paragraphs (b) and (c) in IM-2210-2 would address product identification and liquidity issues raised by variable insurance products communications. These provisions would shorten and simplify the provisions currently contained in paragraphs (a)(1) and (a)(2) of the Guidelines.

Proposed paragraph (b) 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.

Proposed paragraph (c) would prohibit communications from falsely implying that variable insurance products are short-term, liquid investments. Paragraph (c) also would require any 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, any discussion of loans and withdrawals would have to explain their impact on account values and death benefits. These requirements generally reflect provisions contained in the Guidelines.[3]

D. Guarantee Claims and Riders

Communications concerning variable insurance products frequently emphasize guarantees or riders, particularly to the extent that they protect an investor in a down market. FINRA recognizes the need to communicate the features of these guarantees and riders through sales material. However, it is equally important that these communications discuss guarantees and riders in a fair and balanced manner.

Currently, the Guidelines address claims about guarantees but do not specifically address riders. The proposal would incorporate the concepts concerning guarantee claims in the Guidelines and also propose specific provisions regarding riders.[4]

Similar to the Guidelines, 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. In addition, communications regarding guarantees would have to disclose that the investment return and principal value of an investment option are not guaranteed and will fluctuate.

Paragraph (d)(3) of the proposal states that communications that discuss the circumstances under which a guarantee or rider will benefit the customer must be fair and balanced considering the circumstances under which the guarantee or rider will not benefit the customer. While this provision would not require exhaustive disclosure of every circumstance in which a rider would not benefit a customer, any presentation regarding riders could not be one-sided and would have to present a fair and balanced description of the circumstances under which the rider would not benefit customers. In addition, paragraph (d)(4) would require rider discussions to explain the nature of the rider, its costs and limitations and the fact that it is an optional feature of the contract.

E. Qualified Plans

FINRA previously has expressed concerns with recommendations to purchase a variable annuity through a tax-qualified account, such as an individual retirement account. The concerns relate to the fact that a variable annuity does not provide any additional tax-deferred treatment of earnings beyond the treatment provided by the tax-qualified retirement plan itself. FINRA recognizes that there may be reasons other than tax deferral to recommend the purchase of a variable annuity through a tax-qualified account. However, we have reminded firms that a registered representative should recommend the purchase of a variable annuity through a tax-qualified account only when other benefits, such as lifetime income payments, family protection through the death benefit or guaranteed fees, support the recommendation.[5]

The same rationale applies to communications concerning a variable insurance product offered through a tax-qualified retirement plan. Accordingly, paragraph (e) of the proposal would prohibit any such communication from indicating that the tax-deferred treatment of earnings is available only through investment in the contract, and 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.

F. Historical Performance

Proposed paragraph (f) would govern the various types of variable insurance product historical performance that a member firm may include in communications. These provisions generally reflect positions that FINRA staff has taken through the filings review program.

Variable Annuity Performance

Proposed paragraph (f)(1) would provide that member firms may present historical performance in communications regarding variable annuities only in accordance with Rule 482 under the Securities Act of 1933 or Rule 34b-1 under the Investment Company Act of 1940, as applicable.

Variable Life Insurance Policy Performance

Proposed paragraph (f)(2) would allow member firms to present historical performance information in communications regarding variable life insurance policies. The standards imposed by this paragraph generally reflect standards that FINRA staff previously has published regarding variable life insurance policy performance information.[6] At a minimum, this performance must reflect the deduction of all fees and charges applicable at the investment option level.[7]

Communications that present variable life insurance policy performance also would have to prominently disclose:

- whether the performance reflects the deduction of additional fees and charges disclosed in the prospectus other than at the investment option level;
- the fees and charges disclosed in the prospectus not deducted from the performance (*e.g.,* life insurance premiums); and
- that if all fees and charges disclosed in the prospectus had been deducted, the performance quoted would have been lower.

Proposed paragraph (f)(2)(C) would require communications that present variable life insurance policy performance to urge investors to obtain a personalized hypothetical illustration. Upon such investor request, a member firm would be required to provide an illustration that reflects all applicable fees and charges disclosed in the prospectus, including the cost of insurance. The illustration also would have to conform to the provisions governing assumed rate hypothetical illustrations contained in paragraph (g) and would have to be customized to reflect an individual investor's characteristics and preferences.[8]

Presentations of investment option performance in variable life insurance communications would have to be consistent with the standards for the presentation of open-end management investment company performance in SEC Rule 482. Thus, such performance would have to be current to the most recent calendar-quarter ended prior to the submission of the communication for publication, and show the average annual total return for one-, five- and ten-year periods, or since its inception if the investment option's registration statement had been in effect for less than those periods.[9] This requirement is consistent with current industry practice.

Pre-Dated Performance

Proposed paragraph (f)(3) would allow, but not require, member firms to present the performance of an investment option that occurred during the period prior to its availability through the separate account of a variable insurance product. For example, this provision would allow a firm to show an investment option's entire performance history, even if the investment option became available through the separate account subsequent to its inception. This provision reflects current FINRA policy to permit pre-dated performance,[10] subject to certain conditions:

- First, any such presentation would have to meet the requirements of paragraphs (f)(1) and (f)(2), as applicable. Because pre-dated performance is non-standardized performance for purposes of SEC Rule 482, it would have to be accompanied by the investment option's standardized performance if the investment option has been available through the separate account for more than one year. In such a circumstance, the pre-dated performance would have to be accompanied by the investment option's performance commencing on the date it became available through the separate account.
- Second, pre-dated performance for variable annuities either would have to be net of maximum guaranteed charges, or would have to be accompanied by performance that is net of such charges.[11]
- Third, there could not be any significant change to the investment objectives, strategies or policies of the investment option during the period for which performance is shown. For example, it would not be appropriate to present pre-dated performance of an investment option that formerly had the objective of investing in growth stocks and had since converted into a fixed-income fund.
- Fourth, the pre-dated performance could not reflect the performance of a fund that is not available as an investment option through the separate account. Thus, presentation of the performance of a similar "clone" fund that is not available through the separate account would not be permitted.
- Fifth, the communication would have to identify the period during which the pre-dated performance occurred and would have to explain that the performance pre-dates the availability of the investment option through the separate account.

Combined Historical Performance

Proposed paragraph (f)(4) would allow, but not require, a member firm to present the combined performance of multiple investment options, subject to certain conditions:

- First, the presentation would have to satisfy the requirements of paragraphs (f)(1), (f)(2) and (f)(3), as applicable. For example, if the combined historical performance included pre-dated performance, the presentation would have to meet the requirements of paragraph (f)(3).

- Second, the communication also would have to present the individual performance of each investment option included within the combined performance. Again, this performance would have to be consistent with the requirements of paragraphs (f)(1), (f)(2) and (f)(3), as applicable.
- Third, the communication would have to disclose the names of the investment options included in the combined performance, the investment percentage allocated to each investment option for purposes of the combined performance calculation and that the combined historical performance is hypothetical because it is based on assumed investment allocations.

Historical Performance Illustrations

Proposed paragraph (f)(5) would allow, but not require, a member firm to present an illustration based on the historical performance of individual investment options or combinations of investment options using assumed dollar investments, subject to certain conditions:

- First, the illustration would have to be accompanied by historical performance that satisfies the requirements of paragraphs (f)(1), (f)(2), (f)(3) and (f)(4), as applicable.
- Second, the illustration would have to present dollar values that are net of fees imposed at the investment option level, and for variable annuity illustrations, net of maximum guaranteed charges.
- Third, the illustration would have to present year-by-year account values in a tabular or bar-chart format that labels and defines all columns or bars.
- Fourth, the illustration would have to explain that it is based on a hypothetical dollar investment and that it is not intended to predict or project future performance.

Historical Performance of Selected Investment Options

In some cases, a firm may present the performance of one or more investment options without presenting the performance of all investment options available through the separate account. In such situations, the member firm would have to disclose that the investment options depicted are not the only ones offered within a product.

G. Illustrations Based on Assumed Rates of Return

Proposed paragraph (g) would address the use of illustrations that are based on assumed rates of return rather than on investment options' historical performance. Firms could present hypothetical illustrations based on assumed rates of return to demonstrate the way a variable insurance product operates, subject to a number of conditions.

Single Assumed Rates of Return

Proposed paragraph (g)(2) would allow, but not require, member firms to show investment results 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. Assumed rates of return would have to be reasonable considering market conditions and the available investment options.[12]

Proposed paragraph (g)(3) would allow, but not require, a member firm to present an illustration based on an assumed negative annual gross rate of return. Typically, a firm will present a negative assumed annual gross rate of return to show the benefits of a rider that is intended to protect investors in a down market. If a negative assumed rate of return is used, the illustration would have to:

- show negative investment results that reflect the deduction of maximum guaranteed charges; and
- show separate investment results that are based on an assumed positive gross annual rate of return of at least 5 percent and not more than 10 percent and that reflect the deduction of maximum guaranteed charges.

The purpose of requiring the presentation of investment results based on a positive rate of return in addition to the negative return is because, over the long term, market returns have been positive. FINRA staff does not believe it is useful to show illustrations where the annual rate of return is constantly negative without balancing such an illustration by also showing a positive rate of return.

Multiple Assumed Rates of Return

Proposed paragraph (g)(4) would allow, but not require, a member firm to present an illustration based on multiple assumed rates of return that vary year by year. Currently, FINRA staff allows multiple-rate illustrations based on so-called "random" rates that are determined by the member firm. Under this provision, any illustration that uses multiple rates of return would have to be based on the actual performance of a broad-based securities market index for the period shown by the illustration. "Random-rate" illustrations would no longer be allowed to the extent that they do not reflect the actual performance of a broad-based securities index.

The broad-based securities market index would have to be one that is used as a basis for comparison in discussions of fund performance in prospectuses of available investment options. Thus, for example, if the prospectus for an equity investment option shows the performance of the Standard & Poor's 500 Index as the basis of comparison, the actual performance of this index could be used in a multiple assumed rate illustration.[13]

Investment results shown for multiple rate illustrations would have to reflect the deduction of maximum guaranteed charges. The illustration also would have to disclose the broad-based securities market index used and that the index does not reflect the performance of any investment option.

FINRA staff believes that requiring member firms to use the actual performance of a broad-based securities market index, rather than so-called "random" rates, is appropriate for two reasons. First, the historical performance of market indices allows investors to see how a variable insurance product would have operated under actual market conditions, rather than under some assumed random series of returns. Second, the use of broad-based securities market indices would enhance comparisons between products, since many illustrations would use the same index.

While member firms would be permitted to use multiple rates of return based on the actual performance of a broad-based securities market index, communications could not state or infer that index performance reflects or is a proxy for the performance of an investment option available through a variable product.

Other Requirements

Assumed-rate illustrations also would have to meet certain other conditions, regardless of whether they employ a single or multiple assumed rates of return:

- First, all illustrations would have to show investment results that are based on an assumed gross annual rate of return of 0 percent and that reflect the deduction of the maximum guaranteed charges.
- Second, the illustration would have to be presented in a format that is readily understandable and depicts, at a minimum, year-by-year account values.
- Third, the illustration would have to clearly label and define all values and disclose the gross and net rates of return depicted.
- Fourth, the illustration either would have to reflect an arithmetic average of all investment option expenses,[14] or reflect a weighted average of investment option expenses. If a firm chose to use a weighted average, the illustration would have to identify the investment options being used and the investment amount allocated to each option. In addition, if a member firm used an illustration that employed a weighted average of expenses with more than one customer, the illustration would have to reflect the current actual weighted average of investment options held by all investors through the separate account.[15]
- Fifth, the illustration would have to explain prominently that its purpose is to show how the performance of the investment accounts could affect the policy cash value and death benefit, that the illustration is hypothetical and that it does not project or predict future performance.

Although these provisions reflect in part policies that FINRA staff has applied to communications over the years, in some cases (such as with regard to multiple-rate illustrations) these provisions would be new. Firms are invited to comment on whether these provisions provide a useful basis for preparing assumed-rate illustrations. In particular, comment is sought on whether illustrations should be based on current charges imposed on investors rather than the maximum guaranteed charges.

H. Use of Rankings

Proposed paragraph (h) would address the use of rankings in variable insurance products communications. This provision would permit member firms to include rankings in advertisements and sales literature, provided that their use is consistent with the standards contained in Interpretive Material 2210-3 (Use of Rankings in Investment Companies Advertisements and Sales Literature).

I. Investment Analysis Tools

Proposed paragraph (i) would address the use of investment analysis tools in connection with the offer or sale of variable insurance products. Investment analysis tools are interactive technological tools that present the likelihood of various investment outcomes for named investments or investment strategies. Often these tools employ Monte Carlo simulations to project a range of possible outcomes for certain investments. Proposed paragraph (i) would allow the use of such tools, provided that the firm complied with Interpretive Material 2210-6 (Requirements for the Use of Investment Analysis Tools). In addition, member firms would have to employ a tool that either:

- produces results that reflect the deduction of maximum guaranteed charges; or
- provides the user with a personalized hypothetical illustration that reflects these charges.

J. Comparative Illustrations

The proposal also would add new language to paragraph (5) of IM-2210-1 (Guidelines to Ensure that Communications with the Public Are Not Misleading) concerning comparative illustrations of the mathematical principle of tax-deferred versus taxable compounding contained in communications. Much of this language reflects previous guidance that FINRA has provided regarding tax-deferral illustrations.[16] By placing this rule language in IM-2210-1, FINRA is clarifying that these standards apply to any illustration of tax-deferred versus taxable compounding, regardless of whether it appears in a communication promoting variable insurance products or some other communication, such as one discussing the benefits of investing through a 401(k) retirement plan or individual retirement account.

Communications concerning such comparative illustrations would have to meet certain requirements:

- First, the illustration would have to depict both the taxable and tax-deferred investments using identical investment amounts and identical assumed gross rates of return, which could not exceed 10 percent per annum.
- Second, the illustration would have to use and identify actual federal income tax rates.
- Third, the illustration could (but would not have to) reflect an actual state income tax rate, provided that the communication is used only with investors that reside in the identified state.
- Fourth, tax rates used in an illustration that is intended for a target audience would have to reasonably reflect its tax bracket 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 lower capital gains income tax rate.
- Fifth, if the illustration covered the payout period for an investment, the illustration would have to reflect the impact of taxes during this period.
- Sixth, the illustration could not assume an unreasonable period of tax deferral.
- Seventh, the illustration 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.

Endnotes

1 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments).

2 Section 19 of the Securities Exchange Act (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and the rules thereunder.

3 *See* IM-2210-2(a)(2).

4 The proposal would define the term "rider" as "an additional provision to a contract that adds or excludes coverage." *See* proposed paragraph IM-2210-2(a)(6).

5 *See Notice to Members 99-35* (May 1999) (The NASD Reminds Members Of Their Responsibilities Regarding The Sales Of Variable Annuities).

6 See "Presentation Of Variable Life Insurance Performance In Member Communications," NASD Regulation, Inc., *Regulatory & Compliance Alert* (Winter 2001) pp. 3-4.

7 "Investment option" would be defined as "an open-end management investment company (or series thereof) offered through the separate account." *See* proposed IM-2210-2(a)(3). Thus, this provision would require, at a minimum, the deduction of expenses imposed at the underlying fund (sub-account) level, but not the deduction of expenses imposed at the separate account or contract level.

8 *See* proposed IM-2210-2(a)(5).

9 *See* SEC Rules 482(d)(3) and 482(g)(1)(i) under the Securities Act of 1933.

10 *See* IM-2210-2(b)(1). *See also* "Variable Annuity Performance," NASD *Regulatory & Compliance Alert* (Summer 2002) pp. 8-9.

11 The proposal would define "maximum guaranteed charges" as "the maximum recurring and non-recurring charges as disclosed in the prospectus of a variable insurance product that all investors incur at the variable insurance contract level, but does not include charges for optional riders. The term also includes the cost of insurance for purposes of a communication concerning a variable life insurance policy." *See* proposed IM-2210-2(a)(4).

12 In the past, FINRA has permitted assumed rates of return of up to 12 percent per annum, as long as they were accompanied by illustrations showing a 0 percent assumed rate of return. *See, e.g.,* "Internal Rates of Return in Variable Life Hypothetical Illustrations," NASD Regulation, Inc., *Regulatory & Compliance Alert* (Winter 1998), pp. 31-32. FINRA proposes to decrease the maximum single assumed rate of return to 10 percent.

13 Assumed rates of return based on the actual performance of a broad-based securities market index would not be subject to the 10 percent maximum set forth in paragraph (g)(2). In addition, to the extent a broad-based securities market index reflects negative performance in certain years, the illustration would not be required also to show an assumed positive rate of return as required under paragraph (g)(3).

Endnotes (cont'd)

14 The proposal would define "arithmetic average of investment option expenses" as "the number obtained by dividing the sum of all investment option expenses by the number of investment options offered through the separate account." *See* proposed IM-2210-2(a)(1).

15 In the past, FINRA has permitted member firms to reflect a weighted average of fund level expenses in variable life insurance hypothetical illustrations used with more than one customer, subject to certain conditions. The illustration had to be accompanied or preceded by a policy prospectus, and it had to be accompanied by a general illustration that reflects the arithmetic average of underlying fund expenses. See "Fund Level Expenses in Variable Life Hypothetical Illustrations," NASD Regulation, Inc., *Regulatory & Compliance Alert* (Spring 2002) p. 12. FINRA proposes to alter the requirements applicable to the use of a weighted average of expenses with more than one customer by no longer requiring that they be accompanied by a prospectus, and by requiring the illustration to reflect the current actual weighted average of investment options held by all investors through the separate account.

16 *See* "NASD Reminds Members of Their Responsibilities Regarding Hypothetical Tax-Deferral Illustrations in Variable Annuity Illustrations," NASD Member Alert (May 10, 2004).

ATTACHMENT A

Below is the text of the proposed changes to IM-2210-1. New text is underlined.

IM-2210-1. Guidelines to Ensure That Communications With the Public Are Not Misleading

Every member is responsible for determining whether any communication with the public, including material that has been filed with the Department, complies with all applicable standards, including the requirement that the communication not be misleading. In order to meet this responsibility, member communications with the public must conform with the following guidelines. These guidelines do not represent an exclusive list of considerations that a member must make in determining whether a communication with the public complies with all applicable standards.

(1) – (4) No Change.

(5) Tax Considerations

(A) In advertisements and sales literature, references to tax-free or tax-exempt income 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.

(B) A comparative illustration of the mathematical principles of tax-deferred versus taxable compounding must meet the following requirements:

(i) The illustration must depict both the taxable investment and the tax-deferred investment using identical investment amounts and identical assumed gross investment rates of return, which may not exceed 10 percent per annum.

(ii) The illustration must use and identify actual federal income tax rates.

(iii) The illustration also may reflect an actual state income tax rate, provided that the communication is used only with investors that reside in the identified state.

(iv) Tax rates used in an illustration that is intended for a target audience must reasonably reflect its tax bracket or brackets as well as the tax character of capital gains and ordinary income.

(v) If the illustration covers the payout period for an investment, the illustration must reflect the impact of taxes during this period.

(vi) The illustration may not assume an unreasonable period of tax deferral.

(vii) The illustration must disclose, as applicable:

(a) the extent to which tax rates on capital gains and dividends would affect the taxable investment's return;

(b) its underlying assumptions;

(c) the potential impact resulting from federal or state tax penalties for early withdrawals; and

(d) that an investor should consider his or her current and anticipated investment horizon and income tax bracket when making an investment decision, as the illustration may not reflect these factors.

(6) No Change.

Below is the text of the proposed changes to IM-2210-2, which replaces the current text in its entirety.

IM-2210-2. Communications with the Public About Variable Insurance Products

This Interpretive Material applies to all communications with the public about variable insurance products other than institutional sales material.

(a) Definitions

For purposes of this Interpretive Material, the following definitions will apply:

(1) "Arithmetic average of investment option expenses" means the number obtained by dividing the sum of all investment option expenses by the number of investment options offered through the separate account.

(2) "Cost of insurance" means the investor's actual cost of life insurance protection for a variable life insurance policy.

(3) "Investment option" means an open-end management investment company (or series thereof) offered through the separate account.

(4) "Maximum guaranteed charges" means the maximum recurring and non-recurring charges as disclosed in the prospectus of a variable insurance product that all investors incur at the variable insurance contract level, but does not include charges for optional riders. This term includes the cost of insurance for purposes of a communication concerning a variable life insurance policy.

(5) "Personalized hypothetical illustration" means an illustration that conforms to the provisions of paragraph (g) below, customized to reflect an individual investor's characteristics and preferences.

(6) "Rider" means an additional provision to a contract that adds or excludes coverage.

(7) "Weighted average of investment option expenses" means an average of investment option expenses that is proportional to the allocation of assets to each investment option.

(b) Product Identification

All communications must clearly identify the type of product discussed. The communication may not represent or imply that variable insurance products are mutual funds.

(c) Liquidity

The communication may not falsely imply that variable insurance products are short-term, liquid investments. Presentations regarding access to account values must be balanced by a description of the potential effect of all charges, penalties, or tax consequences resulting from redemption or surrender. Discussions of loans and withdrawals must explain their impact on account values and death benefits.

(d) Guarantee Claims and Riders

(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.

(2) Communications that discuss a guarantee must disclose that the investment return and principal value of the investment options are not guaranteed and will fluctuate.

(3) Communications that discuss the circumstances under which a guarantee or rider will benefit the customer must be fair and balanced considering the circumstances under which the guarantee or rider will not benefit the customer.

(4) Any communication that discusses a rider must explain the rider, its costs and limitations, and the fact that the rider is an optional feature of the contract.

(e) Qualified Plans

Any member communication concerning a variable insurance product offered within a tax-qualified retirement plan:

(1) must not indicate that tax-deferred treatment of earnings is available only through investment in the contract; and

(2) must disclose that the contract does not provide any additional tax-deferred treatment of earnings beyond the treatment of earnings provided by the tax-qualified retirement plan.

(f) Historical Performance

(1) Variable Annuity Historical Performance

Members may present historical performance information in communications regarding variable annuities only in accordance with SEC Rule 482 under the Securities Act of 1933 or SEC Rule 34b-1 under the Investment Company Act of 1940, as applicable.

(2) Variable Life Historical Performance

Members may present historical performance information in communications regarding variable life insurance policies only in accordance with the following conditions:

(A) At a minimum, the performance must reflect the deduction of all fees and charges applicable at the investment option level.

(B) The communication must prominently disclose:

(i) whether the performance reflects the deduction of additional fees and charges disclosed in the prospectus other than at the investment option level;

(ii) the fees and charges disclosed in the prospectus not deducted from the performance; and

(iii) that, if all fees and charges disclosed in the prospectus had been deducted, the performance quoted would be lower.

(C) The communication must urge investors to obtain a personalized hypothetical illustration. If an investor requests a personalized hypothetical illustration, the illustration must reflect all applicable fees and charges disclosed in the prospectus, including the cost of insurance.

(D) Any presentation of investment option performance must be consistent with the standards for the presentation of performance information for open-end management investment companies in SEC Rule 482 under the Securities Act of 1933.

(3) Investment Option Performance Predating Its Availability through the Separate Account

Communications may present the performance of an investment option that occurred during the period prior to its availability through the separate account of a variable insurance product ("pre-dated performance"), provided that the communication meets the following conditions:

(A) The presentation of performance satisfies the requirements of paragraphs (f)(1) and (f)(2), as applicable. In particular, if the investment option has been available through the separate account for more than one year, the pre-dated performance is accompanied by performance of the investment option for the period commencing on the date the investment option became available through the separate account.

(B) Pre-dated performance for variable annuities must be, or must be accompanied by performance that is, net of maximum guaranteed charges.

(C) 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.

(D) The communication does not include the performance of a fund that is not available as an investment option through the separate account.

(E) The communication identifies the period during which the pre-dated performance occurred and explains that the performance pre-dates the availability of the investment option through the separate account.

(4) Combined Historical Performance

Members may present combined historical performance of multiple investment options, provided the communication satisfies the requirements of paragraphs (f)(1), (f)(2) and (f)(3), as applicable, and meets the following conditions:

(A) The communication presents individual performance of each investment option included within the combined performance consistent with the requirements of paragraphs (f)(1), (f)(2) and (f)(3), as applicable.

(B) The communication prominently discloses:

(i) the names of the investment options included in the combined performance;

(ii) the investment percentage allocated to each investment option for purposes of the combined historical performance calculation; and

(iii) that the combined historical performance is hypothetical because it is based on assumed investment allocations.

(5) Illustrations Based on Historical Performance

Members may present illustrations based on historical performance of individual investment options or combinations of investment options available through a separate account using assumed dollar investments. Such illustrations must be accompanied by historical performance that satisfies the requirements of paragraphs (f)(1), (f)(2), (f)(3) and (f)(4), as applicable, and must:

(A) present dollar values that are net of fees imposed at the investment option level, and for variable annuity illustrations, net of maximum guaranteed charges;

(B) present year-by-year account values in a tabular or bar-chart format that labels and defines all columns or bars; and

(C) prominently explain that the illustration is based on a hypothetical dollar investment and that it is not intended to predict or project future performance.

(6) Historical Performance of Selected Investment Options

To the extent applicable, communications that present historical performance of one or more selected investment options must disclose that the investment options depicted are not the only ones offered within the product.

(g) Illustrations Based on Assumed Rates of Return

Members may present hypothetical illustrations based on assumed rates of return in communications to demonstrate the way a variable insurance product operates, provided that the illustration meets the following conditions:

(1) The illustration prominently shows investment results that are based on an assumed gross annual rate of return of 0% and that reflect the deduction of the maximum guaranteed charges.

(2) At the member's option, the illustration shows investment results that are based on an assumed positive gross annual rate of return of up to 10% and that reflect the deduction of the maximum guaranteed charges. Assumed rates of return must be reasonable considering market conditions and the available investment options.

(3) At the member's option, the illustration shows investment results that are based on an assumed negative gross annual rate of return and that reflect the deduction of the maximum guaranteed charges. Any such illustration also must show investment results that are based on an assumed positive gross annual rate of return of at least 5% and not more than 10% and that reflect the deduction of the maximum guaranteed charges.

(4) At the member's option, the illustration shows investment results that are based on the actual performance of an appropriate broad-based securities market index for the period shown by the illustration. The broad-based securities market index must be one that is used as a basis for comparison in discussions of fund performance in the prospectuses of available investment options. The investment results must reflect the deduction of the maximum guaranteed charges. The illustration must disclose the broad-based securities market index used and that the index does not reflect the performance of any investment option.

(5) The illustration is presented in a format that is readily understandable and depicts, at a minimum, year-by-year account values.

(6) The illustration clearly labels and defines all values and discloses the gross and net rates of return depicted.

(7) The illustration either:

(A) reflects an arithmetic average of all investment option expenses; or

(B) reflects a weighted average of investment option expenses, provided that:

(i) the illustration identifies the investment options being used and the amount of investment allocated to each investment option; and

(ii) if the illustration is used with more than one customer, it must reflect the current actual weighted average of investment options held by all investors through the separate account.

(8) The illustration explains prominently that its purpose is to show how the performance of the investment accounts could affect the policy cash value and death benefit, that the illustration is hypothetical and that it does not project or predict future performance.

(h) Use of Rankings

Performance rankings may be included in advertisements and sales literature provided their use is consistent with the standards contained in Interpretive Material 2210-3.

(i) Investment Analysis Tools

Members that use investment analysis tools in connection with the offer or sale of a variable insurance product must comply with the provisions of Interpretive Material 2210-6. In addition, members must either:

(1) employ an investment analysis tool the results of which reflect the deduction of maximum guaranteed charges; or

(2) employ an investment analysis tool that provides a personalized hypothetical illustration which reflects the maximum guaranteed charges.