



April 4, 2005

Jonathan G. Katz  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

Via Electronic Mail: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

**Re: File No. S7-06-04; Proposed Rules Requiring Broker-Dealers to Provide Customers with Information Regarding the Costs and Conflicts of Interest Arising from the Distribution of Certain Products, Including Variable Insurance Products**

Dear Mr. Katz:

The National Association of Insurance and Financial Advisors (“NAIFA”) and the Association for Advanced Life Underwriting (“AALU”) submit this letter in response to the request of the Securities and Exchange Commission (SEC) for additional comments on proposed rules requiring broker-dealers to provide customers with information regarding the costs and conflicts of interest arising from the distribution of mutual fund shares, 529 college savings plan interests, and variable insurance products (File No. S7-06-04)(the “Proposed Rule”). We appreciate the SEC’s reopening of the comment period on this proposal.

NAIFA is a national federation of over 700 state and local associations, whose members live and work in every congressional and state legislative district. The 65,000 members of these associations are bound by NAIFA’s Code of Ethics and are full time professionals in insurance and related financial services. Founded in 1890, NAIFA is the nation’s oldest and largest trade association of insurance and financial services professionals. NAIFA’s mission is to enhance the professional skills and promote the ethical conduct of agents and others engaged in insurance and related financial services that assist the public in achieving financial security and independence, and to improve the business environment. A majority of NAIFA members are licensed as registered representatives of broker-dealers and market and service variable annuities, mutual funds and other investment products.

AALU is a nationwide organization of life insurance agents, many of whom are engaged in complex areas of life insurance such as business continuation planning, estate planning, retirement planning, deferred compensation and employee benefit planning. AALU represents approximately 2,000 life and health insurance agents and financial advisors nationwide.

The Proposed Rule would require broker-dealers and their registered representatives to provide their customers with new disclosures regarding the fees and costs associated with the

purchase of mutual funds and variable insurance products. Under the proposal, standardized one-page forms would have to be provided to customers at the point of sale prior to purchase of the security and upon confirmation of purchase. The forms would detail the fees, expenses and other costs associated with purchasing mutual funds and variable products, and indicate the existence of any conflicts of interest in connection with such a purchase.

NAIFA and AALU support clear and meaningful disclosure to investors and purchasers of insurance. The disclosure mandated by the Proposed Rule, however, fails this test. It would largely duplicate prospectus disclosure requirements with which broker-dealers and registered representatives are currently required to comply. The new disclosure is not meaningful, therefore, because it is unnecessary. It is redundant of information already provided to purchasers of mutual funds and variable products. This redundancy would do little to protect consumers and, in fact, could cause confusion and misunderstanding, ultimately leading to less effective consumer protection. For these reasons, as more fully discussed below, NAIFA and AALU urge the SEC to withdraw the Proposed Rule.

**1. Relevant information is already included in the prospectus; additional disclosures would reduce, rather than enhance, the effectiveness of the prospectus.**

The fees, risks and expenses associated with the purchase of mutual fund and variable annuity products are currently disclosed in the products' prospectuses, which are subject to SEC review and approval. If regulators believe consumers are not aware of, or do not understand, the costs incurred in their mutual fund and variable product investments, we believe the solution is to improve the efficacy of the prospectuses, as opposed to mandating another layer of disclosure.

Very recently, in 2002, the SEC took steps to simplify the contents of the prospectus. We believe that was – and is – a good idea. Duplicating information already found in the prospectus by requiring a new, separate disclosure document at the point of sale and at confirmation, however, could serve to undercut any improvements that have been made. Throwing yet another document into the mix could add to the consumer confusion the SEC was seeking to lessen by simplifying the prospectus and could reduce even further the likelihood that consumers will read the most important source of information on the product – the prospectus. Instead of requiring additional, redundant layers of information that is similar to that provided in the prospectus– but just different enough to cause confusion – the SEC should focus on increasing the visibility of the prospectuses and getting consumers to carefully read the information currently provided in those documents.

**2. Variable insurance products are complex financial instruments; focusing solely on the product's costs could lead consumers to ignore important factors they should consider in their investment decision.**

Variable insurance products are complex financial instruments. They are not commodities. Variable products involve numerous “moving parts” – the overall price of the product; prices at different breakpoints; fees and other costs; returns; benefits; the types of underlying securities; the amount of the investment; length of investment; the type(s) of insurance products; the age/health of the insured; the length of the insured life; and others.

These factors together comprise the terms of a product and the specific mix of factors are what make a product unique. This complexity makes it difficult – and, ultimately, misleading – to compare products based on one factor alone, particularly when you also attempt to factor in the specific needs, circumstances and goals of individual investors.

Thus, we believe clients are much better informed if they can see and evaluate all of the relevant information regarding a variable product and, based upon this comprehensive information, compare that product to other products that have their own mix of factors. A one-page fee disclosure document will not present the full picture. Indeed, emphasizing fees over other factors could inappropriately skew an individual's purchase decision. A disclosure that only discusses an investment's fees and expenses could lead people to focus on the investment's costs rather than its overall returns, other benefits (in the case of a variable insurance product) or appropriateness in light of the consumer's specific circumstances and goals. Simply put, which is the better investment—one with low costs and a net annual return of 2%, or an investment with twice the expenses and a net annual return of 6%? What about a product with an insurance component that costs somewhat more but provides additional benefits?

The fact is, it is impossible for a consumer to determine what is best based solely on cost. We recognize that this information is important; it is helpful in the overall decision-making process and in guarding against conflicts. Regulators should not require it to be highlighted over other information, however, because that sends a message to consumers that this information is more important than the other factors to be considered in deciding whether to purchase a product. We do not believe that is the case.

The forms attached to the Proposed Rule illustrate the difficulty of providing standardized targeted disclosure in a vacuum, separate from other relevant information about a product. For example, both Attachment 7 and Attachment 14 make reference to paying sales fees up front. With respect to variable products, however, this is largely inaccurate. The vast majority of these products work like C-share mutual funds in which there is no upfront fee paid by the purchaser. In addition, these attachments fail to clearly address the treatment of partial withdrawals.

The information necessary to help consumers get a comprehensive picture of a product – including fees, costs, expenses – is already available in the prospectus. The advantage of the prospectus over the new disclosures required by the Proposed Rule is that the prospectus is broadly descriptive of the product. By giving a full picture of the terms, costs and benefits of the product, it enables purchasers to compare product-to-product in a way that simply comparing costs does not.

### **3. The disclosure requirement unnecessarily exposes broker-dealers and registered representatives to liability for errors/omissions/inconsistencies**

In addition to being duplicative, the new disclosures required by the Proposed Rule open the door to litigation against broker-dealers and registered representatives, adding to their existing errors & omissions liability exposure. With the promulgation of the Proposed Rule, essentially there would be three disclosures of the same information: disclosure of fees at the

time of the sale and at confirmation, and disclosure of fees and other information in the prospectus. With broker-dealers, registered representatives and their staffs being required to manually calculate the new disclosures, there exists a significant likelihood of unintentional math errors. Furthermore, there could be differences among the three disclosure documents due to changes in the product purchased or the amount purchased, or the use of standardized disclosures as opposed to numbers specific to the transaction. There is also the probability that the client will change the actual amount of the purchase after the forms are sent, perhaps above or below a breakpoint, rendering an earlier disclosure inaccurate. Subsequent disclosures could lead the client to be confused and perhaps angry, erroneously thinking he or she had been misled by the broker-dealer.

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In conclusion, NAIFA and AALU believe that the Proposed Rule should be withdrawn, particularly as it applies to variable insurance products, for two reasons: (i) the disclosures required by the Proposed Rule duplicate information already available in the products' prospectuses; and (ii) focusing on fees alone may cause investors to ignore other critical, necessary information about the investment products they purchase. The prospectus solves any current or anticipated problems. It contains the comprehensive information necessary for consumers to make their investment decisions, and enables them to compare products, not just prices. To the extent the prospectus is thought to be inadequate because of lack of clarity or because it is not easily accessible to investors because of its language, format or for other reasons, that is where the SEC should focus its reform efforts. If the SEC believes that fees should be highlighted in a separate disclosure, the information disclosures should be taken directly from the table of fees and expenses found in the prospectus, thereby avoiding potentially conflicting and confusing multiple disclosures.

Thank you for your consideration of our views. Please contact us if you have any questions regarding our comments.

Yours Truly,

/s/ Gary A. Sanders

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/s/ Thomas F. Korb

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