April 7, 2006

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-9303

RE: File No. S7-06-06

Dear Ms. Morris:

On February 28, 2006, the Securities and Exchange Commission (the "Commission") proposed amendments to the redemption fee rule that it adopted on March 11, 2005.[1] That rule, rule 22c-2 under the Investment Company Act of 1940 (the "Act"), allows registered open-end investment companies ("funds") to impose a redemption fee, not to exceed two percent of the amount redeemed, to be retained by the fund.[2]

This letter of comment on the proposed rules is respectfully submitted by the National Association for Variable Annuities ("NAVA").[3]

Summary of the Redemption Fee Rule

Under rule 22c-2, the board of directors of each fund must either approve a redemption fee or determine that imposition of a redemption fee is either not necessary or not appropriate. In addition, regardless of whether the board approves a redemption fee, each fund must enter into a written agreement with each financial intermediary of the fund, under which the intermediary agrees (i) to provide, at the fund's request, identity and transaction information about shareholders who hold shares through an account with the intermediary, and (ii) to execute instructions from the fund to restrict or prohibit further purchases or exchanges of shares by a

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[1] Release No. IC-27255 (February 28, 2006) (the "Release").
[2] See Release No. IC-26782 (March 11, 2005) (the "Adopting Release"). Throughout this comment letter, release page number references are to the Release as published by the Commission on its Web site.
[3] NAVA is a not-for-profit organization dedicated to the growth and understanding of annuity and variable life insurance products. NAVA represents all segments of the annuity and variable life industry with over 350 member organizations, including insurance companies, banks, investment management firms, distribution firms, and industry service providers.

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shareholder who has been identified by the fund as having engaged in transactions that violate the fund's policies.

Proposed Amendments to Rule 22c-2

The Release states that the proposed amendments address concerns and questions regarding rule 22c-2 that commenters have brought to the Commission's attention and are designed to reduce the costs of complying with the rule and clarify its application in certain circumstances.[4]

The proposed amendments relate to three areas. First, the amendments would limit the types of intermediaries with which funds must negotiate information-sharing agreements. This would be accomplished in two ways - by excluding from the definition of financial intermediary any person that the fund treats as an individual investor with respect to the fund's policies established for the purpose of eliminating or reducing any dilution of the value of fund shares, and by requiring that agreements only be required with intermediaries that submit orders directly to the fund.

Second, the amendments address the rule's application when there are chains of intermediaries and would specify that agreements with "first-tier" intermediaries must obligate such intermediaries to use their best efforts to obtain shareholder information from those intermediaries further down the chain.

Third, the amendments would provide that if a fund is unable to obtain an agreement with a particular intermediary, it must prohibit the intermediary from purchasing shares of the fund.

General Comments

NAVA and its members continue to support the Commission's ongoing efforts to protect fund investors and curtail abusive short-term trading or "market timing" activities within mutual funds that may result in increased costs and lower returns that are borne by long-term investors. Over the past few years, insurance companies have implemented a variety of controls and procedures, added additional market timing restrictions to their prospectuses, and increased their scrutiny of suspicious trading practices to discover and remove market timers from their funds. These restrictions include:

- limiting the number of transfers into and out of a particular subaccount during a given time period;
- rejecting transfers that exceed a stated amount;
- requiring stated minimum amounts to remain in a subaccount following a transfer; and
- requiring that all transfer requests of certain contract owners be made through the U.S. mail rather than via the Internet or by facsimile; and
- requiring that transfer requests contain the original signature of the contract owner.

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[4] See Release at p. 5.

Pursuant to the form amendments adopted by the Commission in April 2004, variable insurance contract prospectuses describe these restrictions and the insurer's policies and procedures for deterring frequent transfers with specificity.

Moreover, separate accounts offered by insurance companies are different from other types of financial intermediaries, such as broker-dealers and other entities that hold securities in nominee name. Most insurance company separate accounts are registered as Unit Investment Trusts. As such, they are considered registered investment companies and are required by Rule 38a-1 of the Act to adopt and implement written policies and procedures reasonably designed to prevent violations of the federal securities laws. These policies and procedures must address the use of fair value pricing of fund shares and compliance with the separate account's disclosed policies regarding market timing. The policies and procedures must be approved by the insurance company and reviewed at least annually. Finally, as registered investment companies, insurance company separate accounts and their market timing procedures are subject to regulation and examination by the Commission.

When adopting rule 22c-2, the Commission requested comment on a number of issues, including "whether we should require a uniform standard for any redemption fees charged by a fund."[5] Potential uniform fee parameters discussed by the Commission included the amount of the redemption fee, length of holding period, share accounting method, and limitation of the fee to transactions initiated by investors. NAVA and many other insurance organizations and insurance companies submitted that the absence of uniform standards for redemption fees will require insurance company separate account to accommodate numerous permutations of varying fees and greatly increase their administrative costs. The Release acknowledges that most commenters agreed that benefits and costs savings would be achieved if the Commission mandated uniform redemption fee standards.[6] However, the Release also states that the Commission is taking commenters' views regarding uniform standards under advisement, but uniform redemption fees standards are not being proposed at this time.[7] NAVA continues to urge the Commission to set uniform standards for those funds that choose to impose redemption fees.

We also believe it is essential that the Commission limit application of redemption fees to short-term transactions initiated by the shareholder. As we explained in our comment letter last year, most variable annuity contracts offer a number of asset management programs that are executed automatically by the insurance company, such as dollar cost averaging programs, interest sweep options and rebalancing and automatic asset allocation programs which automatically maintain the contract owner's desired diversification by periodically reallocating funds among the chosen subaccounts. Insurance companies would likely be forced to discontinue these valuable programs, which are not abusive market timing, if such transactions would trigger redemption fees.

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[5] See Adopting Release at p. 21.
[6] See Release at p. 6
[7] See Release at p. 6.

The Adopting Release recognized that the application of redemption fees to insurance company separate accounts raised some unique issues. The staff stated that it "envision[s] that the rule would not permit the assessment of redemption fees on the redemption, pursuant to partial or full contract withdrawals, of shares issued by an insurance company separate account…"[8] Additional comment was sought as to whether other provisions were needed to address the "special circumstances of insurance company separate accounts."[9]

Again, NAVA and others filed comments raising a number of significant issues that the rule would create for insurance companies offering variable insurance products and recommending potential solutions. We are concerned that the proposed amendments do not provide any relief for the issues raised on behalf of insurance company separate accounts.

The uncertainty created by the absence of any redemption fee standards or resolution of the special circumstances affecting insurance company separate accounts has made it extremely difficult for insurance companies to develop systems to accommodate redemption fees and the exchange of shareholder information with the underlying funds, or even determine what kinds of systems will be needed.

Comments on Proposed Amendments

1. Cost to Insurance Company Intermediaries

The Commission staff states that they anticipate that the proposed amendments will significantly reduce the costs incurred by funds and financial intermediaries from those estimated when the rule was originally adopted. These savings would be the result of modifications to the definition of financial intermediary and the corresponding reduction in the number of intermediaries with which funds must enter into shareholder information agreements. However, none of the proposed amendments provide any relief whatsoever to insurance company separate accounts which continue to be included in the definition of financial intermediary and will continue to be required to enter into agreements with all of their underlying funds. As we noted in our previous comment letter, the costs to insurance company separate accounts will be significant given their two-tier investment company structure and the fact that variable insurance contracts typically offer 30-40 different underlying funds, many of which are unaffiliated with the insurance company.[10]

It is difficult for insurance companies to prepare estimates of the cost to comply with rule 22c-2 because so many factors remain variable at this time. To date, the Commission staff has declined to establish uniform standards for either the redemption fees or the shareholder information agreements.

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[8] See Adopting Release at p. 29.
[9] See Adopting Release at p. 30.
[10] According to the NAVA 2005 *Annuity Fact Book* (fourth edition, 2005), page 25, the average number of funds per variable annuity contract in 2004 was 39.

The staff acknowledged that most commenters asserted that there would be cost savings if the Commission mandated uniform redemption fee standards, but noted that no consensus has emerged as to what those uniform standards should be.[11] In the context of variable insurance products, NAVA again notes that the absence of uniform standards could require insurance companies to implement numerous redemption fees within a single variable insurance contract, with varying fees, holding periods, share accounting methods, exceptions and limitations. It is unquestioned that substantial upgrades to administrative systems and procedures will be necessary for insurance companies to be able to accommodate such variations. The extent and cost of the upgrades will obviously be reduced if redemption fees within a contract are uniform and consistent.

While the proposed amendments specify some of the provisions that must be contained in the shareholder information agreements, other issues remain unknown. For example, the rule does not place any limits on the frequency of funds' requests for shareholder information. While the adopting Release estimated that funds will request shareholder information quarterly,[12] neither the present rule nor the amendments contain any safeguards that funds will not request shareholder information more frequently than quarterly. In fact, we are aware that the Model Agreement drafted by the Investment Company Institute Standardized Data Reporting Working Group includes sample language for "those funds that decide to obtain daily feeds of transaction information."

The original rule proposal in 2004 would have required weekly reporting of shareholder information. The Adopting Release acknowledged that weekly reporting would have resulted in unnecessary burden and cost and modified the proposal to require that intermediaries transmit information at the fund's request. Clearly, if funds are free to request daily reporting of shareholder information, the costs to insurance companies and other financial intermediaries will be enormous. We also question what funds will be able to do with shareholder information provided on a daily basis.

In addition, variation from one fund to another within a variable insurance contract in regard to the frequency of information requests will further increase the complexities and costs for insurance companies to develop systems to respond to the requests.

The rule and amendments also do not provide any guidance regarding the format to be used by funds to request information and for intermediaries to transmit the information, or the time in which intermediaries are to respond to requests.

As noted, the uncertainties described above have made it virtually impossible for insurance companies to determine what kinds of systems they will need to build in order to comply with the final rule. Preliminary estimates that have been completed at this time indicate that the cost to comply with all aspects of redemption fee rule could exceed $2,000,000 per company.

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[11] See Release at p. 6.
[12] See Adopting Release at p. 41.

As an example of the complexity of the job faced by insurance companies, one company provided the following list of systems/procedures that the rule would presently require:

- the ability to establish rules for specific trading behavior on a fund-by-fund basis to identify duration between trades, number of trades in a specified period, dollar amount of trades
- ability to flag specific types of transactions to be either included or excluded from the fund level rules
- ability to calculate varying fees at the contract level and to withdraw the fees from the contract
- ability to apply varying share accounting methodologies at the fund level, such as LIFO or FIFO in determining the assessment of redemption fees
- daily aggregation of redemption fees for each fund, and transmission of the total fee for a fund or group of funds to the custodian of each fund company
- reporting capabilities for transmission of data to the funds. Frequency of transmission of data may be daily and/or on a more periodic basis
- ability to apply rules and/or take direction from fund companies on specific contract owners, to restrict transfers into a fund at the contract level, with the ability to lift restrictions at a later date

Another insurance company estimates that the rule will necessitate changes to 5 administrative systems and between 30 and 50 subsystems.

In order to reduce the burden that will disproportionately be borne by insurance companies by the rule in its present form, we request that the Commission establish the uniform redemption fee standards that were described in our previous comment letter of May 9, 2005. We also request that the rule be amended to specify how often a fund can request shareholder information, and that such requests not be more frequently than quarterly.

2. Extension of Compliance Date for Variable Insurance Products Funds

The Release also requested comment on whether the October 16, 2006 compliance date for execution of written agreements between funds and financial intermediaries should be extended. For a number of reasons, NAVA respectfully submits that an extension is needed.

As discussed above, even with the proposed amendments, all insurance companies offering variable insurance products will be required to enter into agreements with each underlying fund. As also discussed above, variable insurance company separate accounts face many unique challenges not applicable to retail funds and the financial intermediaries that sell them. The insurance industry had hoped that these unique challenges would be addressed by the Commission in response to the comments solicited by the Commission when it adopted rule 22c-2 on May 23, 2005 but, to date, the issues relating to the lack of uniformity for redemption fees and shareholder information agreements continue to hinder companies' ability to develop systems and procedures. The rule in its present form will require insurance companies to make substantial and costly changes to their existing administrative systems in order to accommodate

redemption fees that may be imposed by underlying funds and to comply with the shareholder information sharing requirements of the rule.

While some funds, industry groups and service providers have been working on standard agreement terms and system enhancements to facilitate the transmission of information, these efforts to date have concentrated on the retail fund market. NAVA committees are presently working on developing a standardized agreement for use by the variable annuity industry which will have to be followed by a dialogue with the fund industry in order to reach a mutually agreeable result. This will require a significant amount of work.

As we explained in our comment letter of May 9, 2005, the imposition of a redemption fee on transfers in existing contracts would require, at the very least, the filing of amendments to the contracts with every state. These amendments cannot be filed until all of the funds offered within a contract notify the insurance company whether they will impose a redemption fee and, if so,
the amount of the fee and when and how it will be assessed. It is extremely unlikely, therefore, that required amendments can be filed and approved by the various state insurance departments by October 16, 2006.

There is also no guarantee that state insurance departments will approve amendments that would abrogate existing contract rights. We are very concerned that an insurance company may enter into an agreement with a fund obligating it to administer a redemption fee and trading restrictions imposed by the fund and then have a state insurance department decline to approve an amendment to the contract. This would place the insurance company in the unfair position of either having to breach the agreement with the fund, or possibly having to pay any redemption fee itself which is totally contrary to the purpose behind Rule 22c-2.

Several of our members have informed us that they have discussed these types of changes with various state insurance departments and have been told that any endorsement modifying existing contract rights may not be approved by the departments. Accordingly, we request that the SEC staff contact insurance departments in key states such as New York and California to verify whether they would approve contract amendments that would be required by redemption fees and trading restrictions imposed pursuant to the rule.

Finally, the problems caused by lack of uniformity and difficulties in reaching consensus on the terms of the information-sharing agreements will likely result in insurance companies being unable to enter into agreements with certain funds. These funds will then have to be eliminated as investment options within the variable insurance contracts and replaced with more compatible funds. It is unlikely the substitutions can be accomplished by October 16.

In light of the considerable time it will take for all of the issues to be resolved, NAVA respectfully requests that the compliance date with respect to variable insurance contract funds be extended for 18 months.

3. Existing Variable Insurance Contracts

In our comment letter of May 9, 2005, we stated that redemption fees may raise significant legal issues for existing variable insurance contracts. We noted that, unlike a mutual fund, the purchase of a variable insurance product creates a legally binding contract between the insurance company and the purchaser which set forth the rights and duties of the respective parties. Under state contract law, one party to a contract generally cannot unilaterally modify its terms.

In addition, state insurance laws require that variable contracts specify maximum and guaranteed charges and pricing formulae. Contract provisions also detail limitations or charges applicable to transfers among subaccounts. In some cases, contract provisions guarantee owners the right to make unlimited transfers without charge. In other cases, provisions specify a maximum transfer charge or a minimum number of transfers that can be made without charge.

In both the adopting Release and the most recent Release, the Commission staff's response to these concerns has been to cite Miller v. Nationwide Ins. Co., 2003 WL 22466236, 391 F.3d 698 (5th Cir. 2004) for the proposition that it is the underlying funds imposing any redemption fee, not the insurance company separate account. In the Release, the staff states "we do not believe that redemption fees charged pursuant to rule 22c-2 should be interpreted to cause insurance companies to breach their contracts with annuity holders."[13] The annuity industry sincerely hopes that the staff's "belief" proves to be correct. However, we are not confident that existing contract owners who are assessed a new fee on transfers within their annuity contracts, or who are prohibited from making further purchases or exchanges, will simply relinquish their right to sue to enforce the terms of their contracts. Regardless of their outcome, the costs of defending these actions would be significant.

Moreover, there is no assurance that the Miller case will be found dispositive by other courts. As the SEC staff now recognizes in its most recent citation of the case, while the trial court did cite the fact that it was the fund imposing the fee as one of its three reasons to grant the defendant's motion to dismiss, this was not part of the holding of the Fifth Circuit Court of Appeals. The Court of Appeals affirmed the dismissal on the grounds that the plaintiffs' claim under the Securities Act of 1933 was barred by the statute of limitations and their contract claim required dismissal because of the restrictions placed on state law claims under the Securities Litigation Uniform Standards Act ("SLUSA"). The Court of Appeals specifically stated:

> "[W]e express no opinion as to whether Miller did or did not have a viable claim under the Securities Act or whether he had a valid claim for state law breach of contract. We hold only that the statute of limitations ran as to any Securities Act claim and that SLUSA required dismissal of the state contract claim because plaintiff included with his state contract claim allegations of an untrue statement." 391 F.3d 698 at fn3.

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[13] See Release at p. 5, fn. 12.

Our previous comment letter cited 13 lawsuits that had been filed as of last year against insurance companies by contract owners seeking to enforce transfer rights in variable insurance contracts. Since that letter, we are aware of an additional lawsuit, Kaney v. Allstate Life Insurance Company, Circuit Court of Cook County, Il, No. 03-L-1594, in which the trial judge granted summary judgment in favor of the plaintiff in regard to transfer restrictions. The Court held that the transfer restrictions were in breach of the annuity contracts, and that Allstate may not otherwise unilaterally impose other restrictions on transfer between investments unless required by operation of state or federal law.

Accordingly, because we continue to believe that rule 22c-2 poses very serious litigation risks for issuers of variable insurance products, NAVA respectfully requests that the Commission explicitly and affirmatively state that abusive short-term trading or market timing is harmful to other fund shareholders and against public policy, and that the provisions of rule 22c-2 are intended to have retroactive effect on existing variable insurance contracts and supercede all conflicting state laws and insurance regulations.

4. Other Comments.

Our letter of May 9, 2005 also addressed other questions raised by the Commission regarding variable insurance contracts and alternative methods for assuring the imposition of fees in accounts held through financial intermediaries. These matters are still outstanding and we respectfully refer the Commission to our comments in that letter.

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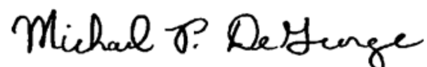
Again, we appreciate the opportunity to comment. If we can answer any questions or be of further assistance, please contact me at (703) 707-8830, extension 20, or Judith Hasenauer at (954) 545-9633. Ms. Hasenauer chairs NAVA's Regulatory Affairs Committee.

Sincerely,



Michael P. DeGeorge
General Counsel