May 8, 2023

Submitted via SEC's Internet Comment Form at: https://www.sec.gov/cgi-bin/ruling-comments

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File Number S7-04-23 – Safeguarding Client Advisory Assets

Dear Ms. Countryman:

On behalf of our members, the Insured Retirement Institute ("IRI")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC") proposal titled, ***Safeguarding Advisory Client Assets*** (the "Proposal"),[2] which would, among other things, amend current Rule 206(4)-2 (the "Custody Rule") under the Investment Advisers Act of 1940, as amended (the "Advisers Act") and re-designate it as Rule 223-1 under the Advisers Act (the "Proposed Rule").

IRI focuses its comments on those aspects of the Proposal that will have the greatest impact on insurance companies issuing protected lifetime income products, such as variable annuities ("VA Contracts") and other insurance products such as fixed annuity contracts, registered index-linked annuities, and fixed-indexed annuities ("Non-VA Contracts," and together with VA Contracts, "Contracts"), as well as the investment advisers providing advice on such products, and their advisory clients who demonstrate a need for them. As explained in further detail below, IRI urges the SEC to make certain changes to the Proposed Rule to ensure that advisory clients maintain equal access to all products and services that an advisory client may access through an investment adviser, including protected lifetime income products. IRI and its membership are particularly concerned that the Proposed Rule could cause advisory clients to lose or have significantly reduced access to both the innovative fee-based products that insurance companies have developed and will continue to develop to provide them with protected lifetime income solutions, as well as the investment advisory services provided in connection with these products.

[1] The Insured Retirement Institute (IRI) is the leading association for the entire supply chain of insured retirement strategies, including life insurers, asset managers, broker-dealers, banks, marketing organizations, law firms, and solution providers. IRI members account for 90 percent of annuity assets in the U.S., include the foremost distributors of protected lifetime income solutions, and are represented by financial professionals serving millions of Americans. IRI champions retirement security for all through leadership in advocacy, awareness, research, and the advancement of digital solutions within a collaborative industry community.

[2] SEC Release No. IA-6240 (Feb. 15, 2023); 88 FR 14672 (Mar. 9, 2023) (the "Proposing Release").

I. The Proposed Rule Should be Amended to Provide an Exception Allowing Insurance Companies to Act in Lieu of a Qualified Custodian in Connection with Contracts.

The Proposed Rule, similar to the Custody Rule, defines the term "qualified custodian" to include a bank or savings association, registered broker-dealer, registered futures commission merchant, and certain types of foreign financial institutions. Insurance companies are not included in the "qualified custodian" definition under either the Custody Rule or the Proposed Rule. The Proposing Release asks whether "insurance companies [should] be included in the definition of qualified custodian under certain circumstances, such as in the variable annuity context."[3] For the reasons set forth below, IRI strongly urges the SEC not to include insurance companies in the definition of qualified custodian in any respect.

Instead, IRI believes the SEC should build on and solidify the current approach under the Custody Rule with respect to Contracts. In this regard, IRI recommends that the SEC revise the Proposed Rule to include an exception that effectively modernizes and brings within the text of the Custody Rule itself the existing no-action relief granted by the SEC staff in 2005 to American Skandia Life Assurance Corporation (the "American Skandia Letter"),[4] thereby allowing insurance companies to act in lieu of a qualified custodian in connection with all Contracts and regardless of the nature of the investment adviser's custody.

In doing so, the SEC would promote advisory clients' continued access to both the innovative fee-based products that insurance companies have developed and will continue to develop to provide them with protected lifetime income solutions, as well as the investment advisory services provided in connection with these products. Furthermore, as explained below, there are various reasons why investors would receive no meaningful investor protection benefit as a result of treating insurance companies as qualified custodians under the Proposed Rule. And finally, an exception that would allow an insurance company to act in lieu of a qualified custodian in connection with a Contract would put insurance companies on equal footing with the mutual fund industry under the Proposed Rule.

A. An Exception to Allow an Insurance Company to Act in Lieu of a Qualified Custodian in Connection with a Contract is Necessary because the Proposed Rule Could Create Regulatory Uncertainty that Does Not Currently Exist under the American Skandia Letter, and Which Could Lead to Adverse Outcomes for Clients who Have a Demonstrated Need for Protected Lifetime Income

For many years, the insurance industry has operated pursuant to the American Skandia Letter to address custodial matters in connection with Contracts advised by SEC-registered investment advisers. The American Skandia Letter concerned a platform established by American Skandia, an insurance company, for unaffiliated investment advisers. The platform enabled these advisers to deduct their advisory fees directly from their clients' VA Contract value by periodically directing American Skandia to redeem contract holders' accumulation units of one or more subaccounts of a separate account organized as a unit investment trust under the Investment Company Act of 1940, as amended (the "Company Act"), equal in value to the advisory fees for the relevant time periods.

Investment advisers participating in the platform were deemed to have custody of client "funds and securities" as a result of their ability to deduct their advisory fees from their clients' VA Contract value

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[3] The Proposing Release at pg. 61.

[4] *See* American Skandia Life Assurance Corp., SEC No-Action Letter (pub. avail. May 16, 2005), *available at*: https://www.sec.gov/divisions/investment/noaction/asl051605.htm.

("Fee Deduction Custody").[5] This Fee Deduction Custody presented an issue under the Custody Rule because the client funds and securities were not being maintained with a "qualified custodian" as such term is defined under the Custody Rule. Instead, they were being maintained with American Skandia, the insurance company issuing the VA Contract. The relief granted by the American Skandia Letter allowed American Skandia to serve in lieu of a qualified custodian with regard to the VA Contracts when an investment adviser utilizing the platform had Fee Deduction Custody.[6]

In the more than eighteen years since the American Skandia Letter was issued, the SEC has not provided explicit guidance as to whether the American Skandia Letter applies to other common circumstances under which an investment adviser may be deemed to have custody over client Contracts subject to the Custody Rule. For instance, in 2009, the SEC amended the Custody Rule to provide that an adviser is deemed to have custody "if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services [the adviser] provide[s] to clients" ("Related Person Custody").[7] The American Skandia Letter necessarily could not have addressed Related Person Custody, which was added to the Custody Rule over four years after the letter's issuance.

By way of further example, the Proposed Rule would expand the definition of custody to encompass "any arrangement (including, but not limited to, a general power of attorney or discretionary authority) under which [an] adviser is authorized or permitted to withdraw or transfer beneficial ownership of client assets upon the adviser's instruction" ("Discretionary Authority Custody").[8] The Proposed Rule would define "discretionary authority" as the "authority to decide which assets to purchase and sell for the client."[9] This proposed expansion of the custody definition would sweep in investment advisers who do not have Fee Deduction Custody or Related Person Custody with respect to client Contracts, but have discretionary authority to determine how to allocate cash values among the investment options in a VA Contract or with respect to the exercise of certain Contract features.

The lack of explicit guidance as to whether the American Skandia Letter would apply to instances in which an investment adviser has either Related Person Custody or Discretionary Authority Custody (whether or

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[5] Relatively recently, a number of issuers of fee-based annuity products received private letter rulings from the Internal Revenue Service stating that an advisory fee deduction from a fee-based annuity cash value would not be treated as a taxable event for purposes of section 72(e) under the Internal Revenue Code. *See, e.g.,* Internal Revenue Service Private Letter Ruling No. 201945001 (Nov. 8, 2019), *available at*: https://www.irs.gov/pub/irs-wd/201945001.pdf; Internal Revenue Service Private Letter Ruling No. 201945002 (Nov. 8, 2019), *available at*: https://www.irs.gov/pub/irs-wd/201945002.pdf; Internal Revenue Service Private Letter Ruling No. 201945003 (Nov. 8, 2019), *available at*: https://www.irs.gov/pub/irs-wd/201945003.pdf. This development was beneficial for advisory clients with a demonstrated need for products providing lifetime guaranteed income and investment advisory services in connection with such products, as it eliminated detrimental tax consequences associated with the convenience associated with paying advisory fees out of product cash values. *See* Investment News, "IRS Delivers 'Game Changer' for Fee-Based Annuities" (Aug. 9, 2019), *available at*: https://www.investmentnews.com/irs-delivers-game-changer-for-fee-based-annuities-80794. As explained in further detail below, it would be an unfortunate step in the wrong direction for these types of advisory clients if, after the relatively recent lifting of this impediment, a new impediment created by the lack of regulatory clarity under the Proposed Rule were to arise.

[6] *See* the American Skandia Letter.

[7] Custody of Funds or Securities of Clients by Investment Advisers, Release No. IA-2968 (Dec. 30, 2009), 75 Fed. Reg. 1455 (Jan. 11, 2010).

[8] *See* Proposed Rule 223-1(d)(3)(ii).

[9] *See* Proposed Rule 223-1(d)(4).

not in addition to Fee Deduction Custody) could create regulatory uncertainty for investment advisers seeking to meet their compliance obligations under the Proposed Rule.[10] In particular, it is not clear under the Proposed Rule and the American Skandia Letter (assuming it remains in place following final action on the Proposed Rule) that an insurance company can act in lieu of a qualified custodian when an investment adviser has either Related Person Custody or Discretionary Authority Custody in connection with a client's Contract. This lack of clarity and the associated regulatory risk could deter such an investment adviser from recommending or advising on a Contract. Ultimately, advisory clients could lose or have significantly reduced access to both the innovative fee-based products that insurance companies have developed and will continue to develop to provide advisory clients with protected lifetime income solutions and the investment advisory services provided in connection with these products.

While commission-based versions of these Contracts would still be available through broker-dealers and other distributors even if the Proposed Rule is adopted in its current form, the cost structures and services provided in connection with fee-based versions of these Contracts may be more appropriate for some retail investors in light of their particular financial circumstances. The Proposed Rule would disrupt and interfere with the ability of such retail investors to decide how best to purchase products that can help them achieve their financial objectives. This result would be detrimental to retail investors and would run counter to one of the SEC's top policy objectives: to preserve retail investor access to a variety of "choices regarding the types of relationships they can have [with investment advisers and broker-dealers], the services they can receive, and how they can pay for those services."[11]

This impact of the Proposed Rule would also deprive certain retail investors who demonstrate a need for fee-based versions of Contracts of access to protected lifetime income, a product feature that many retail investors highly value. For example, in a recent survey of retirement savers, IRI found that there is no trait of a retirement investment product more important to American workers than guaranteed retirement income.[12] As another example, investor interest in fee-based VA Contracts is growing substantially, as a recent survey found that "[f]ee-based VA sales were $1.24 billion in the fourth quarter [of 2021], up 24% from prior year … [which] marks the fifth consecutive quarter of $1 billion+ in fee-based VA product

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[10] With regard to meeting the goals of the Proposed Rule (the safeguarding of client assets), IRI sees no meaningful distinction between an investment adviser who has Fee Deduction Custody – for which an unaffiliated insurance company is explicitly permitted to serve in lieu of a qualified custodian under the American Skandia Letter guidance – and an investment adviser that has Related Person Custody or, if adopted as proposed, Discretionary Authority Custody. In all circumstances, the client asset – the Contract – is held by the client and the assets underlying and supporting the Contract are legally owned by the insurance company and are subject to extensive requirements and restrictions under state insurance laws and federal securities laws, as applicable.

[11] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, SEC Release No. IA-5248 at p. 3 (June 15, 2019); *see also* Regulation Best Interest: The Broker-Dealer Standard of Conduct, SEC Release No. 34-86031 at p. 23 (June 15, 2019) ("[W]e believe that Regulation Best Interest, as modified, appropriately balances the concerns of the various commenters in a way that will best achieve the Commission's important goals of enhancing retail investor protection and decision making, while preserving, to the extent possible, retail investor access (in terms of choice and cost) to differing types of investment services and products.").

[12] *See* "Retirement Readiness Among Older Workers 2021 – IRI Retirement Readiness Research Series," (survey period 3/10/2021 to 3/18/2021), *available at*: https://www.irionline.org/wp-content/uploads/legacy/default-document-library/iri-retirement-readiness-2021_fullreport.pdf.

sales."[13] This survey also found that "[i]n 2021, fee-based VA sales were $4.9 billion, 49% higher than [the] prior year."

In this regard, IRI notes that an investment adviser must tailor its advice to be responsive to an advisory client who discloses or demonstrates a need for a particular product feature, such as protected lifetime income. As recently explained by the SEC staff, an investment adviser has a care obligation pursuant to its fiduciary duty that requires the adviser to have a reasonable understanding of the retail investor's investment profile, which includes any information the retail investor may disclose in connection with the recommendation or advice (such as a need for protected lifetime income).[14] Based on that understanding (as well as an understanding of available products and investment strategies), the adviser must have a reasonable basis to conclude that the recommendation or advice provided is in the retail investor's best interest.[15] If adopted as currently constructed, the Proposed Rule would impair advisory clients' access to products providing protected lifetime income, thereby frustrating the ability of many investment advisers to provide advice in their clients' best interests.

These unfortunate outcomes could be avoided entirely through the adoption of an exception to the Proposed Rule's qualified custodian requirement that effectively modernizes the American Skandia Letter, allowing insurance companies to act in lieu of a qualified custodian in connection with all Contract types, regardless of whether the investment adviser has Fee Deduction Custody, Related Person Custody, or Discretionary Authority Custody (if adopted as proposed).

B. An Exception to Allow an Insurance Company to Act in Lieu of a Qualified Custodian in Connection with a Contract is Warranted because of the Unique Nature of Contracts

Application of the Proposed Rule is predicated on an investment adviser having "custody" of "client assets." The Proposed Rule defines "custody" as an adviser, or its related person, "holding, directly or indirectly, client assets, or having any authority to obtain possession of them . . . in connection with advisory services [the adviser] provide[s] to clients."[16] As explained in further detail below, in connection with Contracts used in the advisory context, aside from instances of Fee Deduction Custody[17] or other forms of custody that allow the adviser to access client assets, such as a general power of attorney, there is no "client asset" that an investment adviser can actually possess.

Contracts present a unique situation under the Proposed Rule. In the insurance context, the document evidencing the purchase of the product is delivered to the purchaser (the "Contract Owner") upon issuance. Therefore, the client (*i.e.*, the Contract Owner who receives advisory services in connection with the Contract) has possession of the asset, not the adviser or the insurance company.

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[13] LIMRA News Release, "Secure Retirement Institute: Total U.S. Annuity Sales Highest Since the Great Recession" (Mar. 10, 2022), *available at*: https://www.limra.com/en/newsroom/news-releases/2022/secure-retirement-institute-investors-seeking-protection-and-greater-returns-propel-total-u.s.-annuity-sales-to-highest-since-the-great-recession/.

[14] *See* "Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Care Obligations" (Apr. 20, 2023), *available at*: https://www.sec.gov/tm/standards-conduct-broker-dealers-and-investment-advisers.

[15] *See id.*

[16] *See* Proposed Rule 223-1(d)(3).

[17] In the American Skandia Letter, it was acknowledged that the investment advisers participating in the insurer's program has custody of client assets due to their ability to deduct fees from the Contract Owner's VA Contract value.

While VA Contracts are funded by separate accounts registered as investment companies under the Company Act that pass through the investment performance of the insulated insurance company separate accounts funding the VA Contracts to Contract Owners, under state insurance laws, the insurance company (and not the Contract Owner) legally owns the assets of its separate accounts, including shares of the insurance funds purchased by the insurance company. This legal ownership is reflected on the books and records of both the insurance company and the fund transfer agent. Since the insurance company legally owns the underlying insurance fund shares, those shares are not "client assets" for purposes of the Proposed Rule.

Similarly, in connection with Non-VA Contracts, the underlying assets supporting the contractual promises made to the Contract Owner are legally owned by the insurance company. In particular, the contract values, benefits, and guarantees provided by Non-VA Contracts are paid out of assets held in the insurance company's general account or a non-unitized separate account.[18]

In sum, with respect to Contracts held in the advisory context, there are no "client assets" held directly or indirectly by either an investment adviser or an insurance company within the meaning of the Proposed Rule. Contract Owners own and hold their VA Contracts and Non-VA Contracts, and the insurance company legally owns the assets of the separate account (*i.e.*, the shares of the insurance funds), non-unitized separate account or general account, aside from instances of Fee Deduction Custody or other forms of custody that allow the adviser to access client assets, such as a general power of attorney. Due to the absence of a client asset being held by the investment adviser or the insurance company in these circumstances, no meaningful investor protection benefit would be achieved by treating insurance companies as qualified custodians under the Proposed Rule. Given the unique nature of Contracts, the Proposed Rule should be amended to include an exception that would allow an insurance company to act in lieu of a qualified custodian in connection with a Contract.[19]

C. An Exception to Allow an Insurance Company to Act in Lieu of a Qualified Custodian in Connection with a Contract is Warranted because of the Substantial Investor Protections Already Available to Contract Owners

Treating insurance companies as qualified custodians under the Proposed Rule would not result in any meaningful benefit for Contract Owners because they already receive substantial investor protections under other applicable laws as well as common practices in the insurance industry. Many of these investor protections are comparable to those that mutual fund investors receive as a result of their fund interests being held by mutual fund transfer agents. For example:

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[18] State insurance law generally requires an issuing insurance company to establish a separate account to fund a registered index-linked annuity ("RILA"). Given that there is no direct pass-through of separate account performance in the case of a RILA (as there is with a variable annuity), the separate account used to support the RILA is a "non-unitized separate account" – meaning that the separate account does not issue "units" of interest. The values, benefits and guarantees provided by RILAs are paid out of assets held in the insurance company's non-unitized separate account and the benefits due to a RILA Contract Owner are not directly related to the value of the assets held in the non-unitized separate account.

[19] While Fee Deduction Custody in connection with insurance products would result in custody under the Proposed Rule, IRI believes that the relief set forth in the American Skandia Letter in this regard is consistent with an exception that would allow insurance companies to act in lieu of a qualified custodian in connection with insurance products.

- Upon issuing a Contract, an insurance company generally is required under state insurance law to send the Contract to the Contract Owner. Thus, the client (*i.e.*, the Contract Owner who receives advisory services in connection with the Contract), rather than the investment adviser providing advisory services in connection with the Contract or the insurance company, maintains custody of the Contract.

- State insurance "free look rights" give the Contract Owner the right to return a Contract for a full refund within a limited period of time following delivery of the Contract.

- VA Contract purchase payments are generally invested in one or more investment options underlying insurance company separate accounts, which are registered under the Company Act. Contract Owners may apply the value of their payments to the various investment options available in the separate account according to their desired allocation. The investment options underlying VA Contracts typically consist of shares of open-end management investment companies that are themselves registered with the SEC under the Company Act. Unlike other types of securities, the assets in VA Contracts, and any resulting appreciation, are legally owned by the issuing insurance company and not the Contract Owners.

- The assets in insurance company separate accounts, while owned by the insurance company under state insurance law, are legally segregated from the insurance company's other assets, and are insulated from the claims of the insurer's general creditors. Since the investment experience of the separate account assets determines the VA Contract benefits, the SEC treats each separate account as a distinct investment company that must register as an investment company under the Company Act unless an exemption is available.[20] The insurance company is treated as the sponsor or "depositor" of the separate account investment company.[21] The insurance company is the owner of the underlying insurance fund shares held in the separate account (in uncertificated or "book entry" form). The performance of the insurance funds directly affects the cash value of the VA Contracts.

- Through administrative systems, insurance companies maintain records concerning Contract Owner purchases of Contracts. Such systems typically record, among other things, the timing and

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[20] *See Prudential Ins. Co. v. S.E.C.*, 326 F.2d 383 (3d Cir. 1964); 15 U.S.C. § 80a-2(a)(37) (2009) (defining separate account under the Company Act); *see also* 17 C.F.R. §§ 270.0-1(e), .6e-2(a), .6e-3T(a) (2009). *See generally* Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U.L. REV. 177 (1971).

[21] Separate accounts funding VA Contracts can be structured in one of two ways. The separate account can invest directly in a portfolio of securities or other investments. This type of separate account, which was the predominant structure during the early years of variable contracts, is typically called a "managed account" and is classified as an open-end management company under the Company Act. Under the managed account structure, the active management of the investment portfolio occurs at the separate account level, like other open-end management companies (*e.g.*, mutual funds).

The second type of separate account structure involves two tiers. Instead of the separate account investing directly in securities or other investments, it is not actively managed, and simply invests in the securities of other specified investment companies whose portfolios, in turn, may be actively managed. This type of separate account is classified as a unit investment trust ("trust account") under the Company Act. The underlying investment is typically a mutual fund ("insurance fund").

Most VA Contracts in the market today are offered through this two-tier structure involving a trust account and insurance fund. Accordingly, this letter addresses separate accounts structured as trust accounts.

amount of purchase payments and withdrawals, Contract Owner allocations, cash values, and death benefit values, and designate for each Contract Owner an "account" in the Contract Owner's name. Each transaction associated with a Contract is entered or fed through a systematic feed and updates a variety of supporting tables that record Contract values (such as cash value or death benefit value) and data at the Contract level. Contract data includes owner/annuitant name, social security number, date of birth, owner type and addresses.

- A VA Contract Owner may permit an investment adviser providing advice in connection with the VA Contract to deduct its advisory fees directly from the separate account that supports the VA Contract by periodically directing the insurance company to redeem units of the separate account equal in value to the advisory fees owed to the investment adviser – as was the case with regard to the program discussed in the American Skandia Letter. Similar arrangements can be made in connection with Non-VA Contracts. In such arrangements, Contract Owners authorize (in writing) investment advisers to submit fee deduction requests to the insurance company. While the logistics by which advisory fees are deducted vary across companies, upon receiving requests (typically quarterly) from investment advisers to deduct their advisory fees, the insurance companies make the appropriate redemptions and deductions to pay such fees.
- Insurance companies typically send quarterly account statements to Contract Owners that identify the funds and securities in their accounts at the end of the period and all transactions in the account during that period, including payments of any advisory fees to investment advisers. These statements permit Contract Owners to monitor the amount of payments to their investment advisers and the allocation of their purchase payments and cash values. These statements allow Contract Owners that have authorized fee deduction from their Contract values to determine if their investment advisers have appropriately charged for their advisory services.
- Because the Contract itself specifies the manner in which the amount owed by the insurance company to the Contract Owner is calculated, the investor protection issues associated with most types of investments are not present with Contracts. The fact that the insurance company's obligation is established by the terms of the Contract fundamentally differentiates these investments from almost all other assets. The insurance company has a legal obligation to comply with the terms of the Contract, which provides an additional layer of protection for Contract Owners against any potential efforts to reach into the assets supporting Contracts by investment advisers who do not have Fee Deduction Custody or other forms of custody that allow the adviser to access client assets, such as a general power of attorney.
- VA Contract separate account "units" do not have any value to anyone except the Contract Owner. For instance, the units cannot be sold, transferred, negotiated, misappropriated, or otherwise converted for personal use by the insurance company, the investment adviser, or any other person; they exist for the sole purpose of calculating the variable benefits owed to the Contract Owner under the VA Contract.

One of the key investor protection elements of the Proposed Rule is the requirement that all qualified custodians enter into written agreements with advisers having custody over client assets providing, among other things, that the qualified custodians will annually provide the investment advisers internal control reports with respect to the safeguarding practices over such assets.[22] This requirement simply cannot be implemented in the context of Contracts. For example, the internal control report must include the accountant's opinion as to whether the qualified custodian's controls have been placed in operation as of a specific date, are suitably designed, and are operating effectively to meet control objectives relating to custodial services, including the safeguarding of the client assets held by that qualified custodian during the year.[23] In the context of Contracts, it is unclear which controls of the insurance company would apply since the insurance company (and not the Contract Owner) owns and controls the assets. In fact, it is not clear what the "assets" are over which controls are to be examined post-issuance of the Contract. What are the "assets" that must be safeguarded?

As described in detail above and as supplemented below, assets supporting Contracts are more than adequately protected under (as applicable) (1) state insurance law,[24] (2) the Company Act,[25] (3) the Securities Act of 1933, as amended (the "Securities Act"), (4) the Securities Exchange Act of 1934, as amended (the "Exchange Act"),[26] and (5) the Sarbanes-Oxley Act ("Sarbanes-Oxley").[27] Taken together, this framework provides extensive protection for the assets of the separate account, including a level of transparency, oversight, independent checks and balances, internal controls, and reporting that makes it unnecessary to treat insurance companies as qualified custodians under the Proposed Rule. Therefore, given these protections, the Proposed Rule should be amended to include an exception that would allow an insurance company to act in lieu of a qualified custodian in connection with a Contract.

D. An Exception to Allow Insurance Companies to Act in Lieu of a Qualified Custodian in Connection with Contracts is Warranted because it Would Put Insurance Companies on Equal Footing with the Mutual Fund Industry Under the Proposed Rule

The similarity between an insurance company's role with respect to Contracts and a transfer agent's role with respect to mutual fund shares formed the basis for the SEC staff's relief in the American Skandia

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[22] *See* Proposed Rule 223-1(a)(1)(i)(C).

[23] *Id.*

[24] In addition to the separate account segregation requirements described above, state insurance regulatory authorities are charged with overseeing insurance companies domiciled or operating in their states and regularly examine the operations and books and records of insurance company separate accounts to ensure compliance with applicable state insurance laws. An insurance company issuing a Contract is also required to file quarterly and annual reports regarding its financial condition, as well as annual reports on the financial condition of any separate accounts the company maintains in connection with VA Contracts.

[25] In addition to the separate account registration requirements under the Company Act discussed above, Item 23 of Form N-4 mandates that financial statements prepared in accordance with generally accepted accounting principles must be filed and audited. Moreover, independent auditors must provide their consent to include their audit opinion on audited financial statements in Form N-4 filings. Moreover, pursuant to Rule 38a-1 under the Company Act, a separate account is required to adopt, implement and annually review written compliance policies and procedures reasonably designed to prevent violations of the federal securities laws, and must also designate a chief compliance officer to administer such policies and procedures.

[26] Although not directly discussed above, it should be noted that anti-fraud provisions under both the Securities Act and the Exchange Act impose liability in connection with a separate account registration statement. Together, these provisions effectively require a registration statement to be free of any material misstatements or omissions.

[27] Sarbanes-Oxley imposes a number of audit and other requirements on separate accounts, since such accounts are considered "issuers" under Sarbanes-Oxley and "audit clients" under Regulation S-X. The audit requirements further assure the safety and soundness of assets maintained in an insurance company's separate account.

Letter. A primary argument of the request for relief was that an insurance company "acts like a mutual fund transfer agent with respect to the contract holders' variable annuity contracts and units of the separate accounts" and that, therefore, insurance companies "protect contract holders' funds and securities from misappropriation by . . . investment advisers . . . to the same extent as a mutual fund transfer agent."[28] The addition of an explicit exception for insurance companies in the Proposed Rule would be consistent with how the SEC treats mutual fund transfer agents.

The SEC's acknowledgment of the similarities between insurance companies and mutual fund transfer agents in the custody context necessitates consideration by the SEC as to why the two receive disparate treatment under the Proposed Rule – with insurance companies relying on limited no-action guidance from SEC staff and mutual fund transfer agents being granted a specific exception by the SEC in the Custody Rule. For these reasons, IRI believes that it would be appropriate for the SEC to add an explicit exception to the Proposed Rule that would allow insurance companies to act in lieu of a qualified custodian in connection with Contracts.

Conclusion

Thank you again for the opportunity to provide these comments. If you have questions about our comments on the Proposal, or if we can be of any further assistance in connection with these important regulatory questions and considerations, please feel free to contact the undersigned at emicale@irionline.org or jberkowitz@irionline.org.

Respectfully submitted,

Jason Berkowitz
Chief Legal & Regulatory Affairs Officer
Insured Retirement Institute

Emily C. Micale
Director, Federal Regulatory Affairs
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[28] *See* American Skandia Letter.