



Securities Industry Association

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September 19, 2005

Jonathan G. Katz
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-9303

Re: Release No. 34-52046A; File No. SR-NASD-2004-183

Dear Mr. Katz:

The Securities Industry Association (SIA)¹ is pleased to submit comment on the referenced release ("Release") regarding Amendment No. 1 to proposed new NASD Rule 2821 governing deferred variable annuity sales practices and supervisory procedures ("Rule Proposal"). The SIA previously submitted comment directly to the NASD on August 4, 2004 in response to NASD Notice to Members 04-45. While the Rule Proposal addressed some of the concerns expressed in our comment letter, the SIA respectfully submits that as presently drafted the Rule Proposal nonetheless continues to be duplicative, expensive and potentially counterproductive to the objective that investors be provided meaningful information regarding the purchase of a deferred variable annuity.

SIA commends the NASD for undertaking to enhance its regulatory requirements relating to the training and supervision by member firms effecting transactions in deferred variable annuities ("DVAs"). SIA would agree that by requiring product-specific training and specific written supervisory policies and procedures, the NASD achieves its goal of greater investor protection. However, SIA believes that the NASD's current rules and regulations satisfactorily achieve its stated objectives regarding suitability determinations and the benefit of an additional rule will be incremental at best and not significantly improve upon the existing regulatory regime.² We further believe that the Rule Proposal is premature, and that the NASD should complete the analyses currently being undertaken by its Variable Annuity Task Force prior to adopting the Rule Proposal. Further, the NASD should identify and quantify trends in customer investments in, and complaints

¹ The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated \$236.7 billion in domestic revenue and an estimated \$340 billion in global revenues. (More information about SIA is available at: www.sia.com.)

² NASD has issued *Notice to Members* 99-35 (May 1999) (providing guidance as to appropriate policies and procedures relating to transactions in variable annuities), *Notice to Members* 96-86 (Dec 1996) (reminding members of their suitability obligations regarding variable annuity transactions, including specific factors to consider in making a suitability determination), *Regulatory & Compliance Alerts* entitled "NASD Regulation Cautions Firms for Deficient Variable Annuity Communications," and "Reminder – Suitability of Variable Annuity Sales" in 2002 and *Investor Alerts* entitled "Should You Exchange Your Variable Annuity?" (2001), "Variable Annuities: Beyond the Hard Sell" (2003). The NASD also makes e-learning training modules available to members.

concerning, DVAs before adopting any new or modified rules that would have a significant adverse economic impact on the broker-dealer community without measurable improvement in the ability of investors to make informed decisions.

In light of the foregoing, the SIA cannot support the current form of the Rule Proposal. As detailed below, we have serious concerns about the vagueness of requirements within the Rule Proposal, its misplaced emphasis on prior supervisory review and approval of all transactions and the difficult and burdensome practicalities in light thereof.

A. *Certain Provisions of the Rule Proposal are Vague and Difficult to Implement.*

The Rule Proposal requires that prior to recommending a purchase or exchange of a DVA, the member or its associated person have a reasonable basis to believe the customer has a “long-term” investment objective, and a “need” for the features of a DVA as compared to other investment vehicles. The NASD has not defined what either a “long term” investment objective or “need” would be in connection with an investment in a DVA. The vagueness of these terms render them impossible to implement. To some of our clients, a one-year goal would qualify as “long-term” while to others “long-term” is twenty years. Assuming, *arguendo*, that a workable definition is provided for what constitutes a “long-term” investment objective, there may be instances when a transaction in a DVA may be suitable for a customer who has an objective that is less than whatever minimum standard is established. The Proposed Rule would presumptively foreclose that opportunity to an investor and deem the sale to that customer *per se* unsuitable.

Moreover, the imposition of a “needs” analysis as compared to other investment vehicles is completely divergent from existing regulatory requirements for investment recommendations.³ The financial services industry makes available a wide array of securities that are designed to provide investors with a multitude of choices to achieve the same objectives. Under the current regulatory scheme, a member and its associated persons may recommend to a customer several investments from that array which would be deemed suitable in achieving the customer’s investment objectives in light of the individual circumstances of that customer.⁴ The Rule Proposal, in effect, would require a member, its supervisors and its associated persons to first determine that a DVA is the sole, unique investment to satisfy the needs of a customer. Member firms have not heretofore been required to ensure investors maintain portfolios of “preferred” investments. Such a standard is impossible to implement, impractical and will subject members to unnecessary “second guessing” liability for any transaction in a DVA. In addition, we question how member firms could systematically conduct surveillance for compliance? Any meaningful surveillance program, if possible, will be expensive, time consuming and burdensome to develop and maintain. These provisions are also likely to have a significant negative impact on the availability of this legitimate investment option to investors.

SIA, therefore, respectfully requests that paragraph 2821(b)(1) of the Rule Proposal be removed in its entirety or at a minimum, be revised to omit the requirement to compare the DVA investment to other investment vehicles. As described more fully below regarding NASD’s existing regulatory regime, SIA would propose that any rule or regulation governing transactions in variable

³ We note that the NASD expressly forbids comparisons of certain investments with other investment vehicles or otherwise limits the products and methodology by which such comparisons may be made. *See*, NASD IM-2210-2(5) and 2210-8(b)(1)(B).

⁴ NASD Rules 2310, 2860, and 2865.

annuities by member firms require prompt supervision which can incorporate the guidance provided to date.

B. *Supervision of Transactions in Deferred Variable Annuities Should Follow the Current NASD Regulatory Regime Generally or As Otherwise Established for Other Types of Investments Specifically.*

SIA believes that the NASD should seek to implement rules for the supervision of DVA investments similar to those required generally or, as an alternative, to those required for other types of investments specifically.⁵ NASD requires that each member firm establish procedures for the “review and endorsement by a registered principal in writing, on an internal record, of all transactions”⁶ effected in clients’ accounts. In addition, member firms’ procedures generally require the prior approval of a registered principal prior to the opening of an account or promptly after the completion of a transaction for the account.⁷ In the instance where the NASD maintains rules for specific types of investments, members must approve a customer generally for transactions in the subject securities prior to an initial transaction and supervise all subsequent transactions effected thereafter. The requirement to approve every DVA purchase or exchange prior to its transmission to the relevant insurance company will be burdensome, costly, and potentially harmful to investors.

We believe the NASD’s general supervisory requirements are meaningful and adequate. We do not believe the NASD has sufficiently demonstrated that member firms’ supervisory systems are flawed with regard to transactions in DVAs such that a separate rule is warranted. We reiterate our request the the NASD be required to complete the analyses currently being undertaken by its Variable Annuity Task Force prior to adopting the Rule Proposal. Therefore, SIA respectfully requests that paragraph 2821(c)(2) be modified to require “prompt supervision” of all transactions in DVAs. In the alternative, the NASD should seek principal approval prior to execution of an initial DVA transaction. In doing so, the NASD will achieve its objective of investor protection while not unduly subjecting investors to unnecessary delay in executing subsequent suitable investments in DVAs.

SIA reiterates its objections outlined above to the requirements that clients must appear to have a “need for the features of a deferred variable annuities as compared with other investment vehicles” and the presumption that variable annuities are long-term investments without further clarification on the definition of this term. We therefore request that paragraph 2821(c)(1)(A) and 2821(c)(1)(B) be removed in their entirety.

While the Rule Proposal permits member firms to establish their own criteria with regard to certain other information that is to be considered by its principals in reviewing and approving transactions in DVAs, we would request that any reference to a customer’s net worth be modified to “customer’s stated net worth”. NASD suitability standards require that associate members undertake a reasonable inquiry into a client’s financial circumstances. NASD has long recognized that clients may be selective in the information provided to member firms.

⁵ See, Footnote 4.

⁶ NASD Rule 3010(d).

⁷ NYSE Rule 405.

C. *Documenting Customer Informed of Material Features of Variable Annuities is Tantamount to Requiring Member Firms to Create Additional Disclosure Statements.*

SIA objects to the requirement that member firms document that clients have been informed of the material features of a DVA and that principals review such documentation for each transaction. SIA considers this to be a “repackaging” of the Risk Disclosure statement included in the original proposed rule.⁸ SIA objects to the proposed documentation requirement for many of the same reasons SIA objected to the originally proposed Risk Disclosure Statement.

An investor purchasing a deferred variable annuity must receive a prospectus prepared by the issuer which contains detailed discussions of the material features that the NASD believes need to be highlighted.⁹ SIA respectfully suggests that the more appropriate avenue to ensure that enhanced, uniform disclosure to investors occurs would be through the offering process by issuers and regulated by the Securities and Exchange Commission. A summary description of the security that would include a discussion of the material features outlined by the NASD is already included in the DVA prospectus. The prospectus is the principal disclosure document intended to inform investors in making an investment decision. SIA believes the focus should not be on creating more documents for investors to review but rather better disclosure applied uniformly. Simply put, it is the quality, not the quantity, of disclosure that matters. Furthermore, the most appropriate party to prepare the product specific disclosure that the NASD believes is critical is the DVA’s issuer, the party that prepares and files the prospectus.

SIA believes that, as a practical matter, the Rule Proposal will cause member firms to draft yet another document requiring a client signature and subsequent retention in order to effectively demonstrate that an associated person has discussed the material features of a DVA with a client. It will be very costly to prepare such documentation for every DVA that a member firm makes available to its customers and, for the reasons outlined above, duplicative. Therefore, under the current proposed regulatory scheme which incorporates recent regulatory initiatives,¹⁰ a purchaser of a DVA would receive the following:

- a current variable annuity prospectus;
- a disclosure of expected sales loads and fees, revenue sharing and special compensation;
- documentation highlighting the DVA’s material features;
- a summary of revenue sharing and differential compensation arrangements;
- a disclosure form for qualified annuities, if applicable; and
- a Replacement Disclosure and State/Firm-required replacement disclosure form, if applicable.

⁸ Notice to Members 04-45, June 2004.

⁹ In footnote 15 of the Release the NASD describes the material features of a DVA as (1) the surrender period; (2) potential surrender charge; (3) potential tax penalties (4) mortality and expense fees (5) investment advisory fees; (6) charges for and features of enhanced riders, if any (7) insurance and investment components of DVAs; and (8) market risk.

¹⁰ The SEC has recently proposed new rules and rule amendments to require broker-dealers to provide customers with disclosures at the point of sale and in transaction confirmations regarding costs and conflicts of interest that arise from the distribution of mutual fund shares and unit investment trusts (including insurance securities) (Release Nos. 33-8358 and 34-49148 (January 29, 2004) 69 FR 6438 (February 10, 2004) and the NASD has proposed amendments to Rule 2830 regarding written disclosure of revenue sharing and differential cash shares which may extend to variable annuities (Notice to Members 03-54 (September 2003)).

While SIA fully supports regulatory efforts that ensure investors have the necessary tools to make informed investment decisions, we believe that there is a significant risk in inundating investors with repeated disclosures regarding material information regarding the investment that is prepared separately. Accordingly, we respectfully request that the SEC consider means by which investors receive uniform disclosure.

D. *A Transition Period to Implement Is Necessary.*

To the extent the Rule Proposal is adopted, a period of at least one year should be provided to implement the provisions of a new rule. Member firms will be confronted with significant modifications to supervision, compliance and training systems and must be allowed adequate time to develop and test such systems.

Conclusion

SIA appreciates the opportunity to provide comments on the Rule Proposal. While the SIA commends the NASD's efforts to improve the quality and usefulness of disclosure and sales practices within the context of variable annuity transactions, we believe the SEC should ensure that a more consistent, uniform regulatory scheme be adopted after completion of any current study underway. If you have any questions or would like to discuss our comments further, you can contact the undersigned at (202) 216-2000 or Eileen Ryan at (212) 618-0508.

Very truly yours,

Ira D. Hammerman
SIA Senior Vice President and
General Counsel

cc: Mary Schapiro, Vice Chairman & President, Regulatory Policy & Oversight, NASD
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