Public Investors Arbitration Bar Association

June 26, 2008

VIA E-MAIL TO RULE-COMMENTS@SEC.GOV

Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SR-FINRA-2008-019
Rule Proposal Regarding Standards and Supervisory Requirements for Deferred Variable Annuities

Dear Ms. Harmon:

Thank you for the opportunity to comment on the above-referenced proposal to amend NASD Rule 2821 regarding sales practice standards and supervisory requirements for transactions in deferred variable annuities. I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"). PIABA respectfully requests that the SEC reject the proposed rule.

PIABA is a bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums. Our members and their clients have a strong interest in FINRA rules relating to the supervision of the sale of deferred variable annuities, due to their extremely large annual sales volume combined with widespread sales practice abuses, no doubt attributable to the high commissions paid on these products. We also note that the victims of these abuses are predominately senior citizens who have a particular need for the protections effective supervision can provide.

The Insurance Information Institute reported that as of December 31, 2007, the net assets invested in variable annuities amounted to $1.485 trillion and variable annuity sales for 2007 exceeded $160 billion.[1] It is quite clear that many American savers and investors have committed significant money to variable annuities, and it is of utmost importance that these products be closely scrutinized.

[1] *See* http://www.iii.org/media/facts/statsbyissue/annuities/.

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I. The Extensive Criticism of Variable Annuities Demonstrates that *Greater* Supervision of These Financial Products Is Needed

FINRA proposes to change Rule 2821 to reduce the supervision burden for broker-dealers selling deferred variable annuities. It appears that the main purpose of these changes is to lower costs, especially for broker-dealers that "offer low-priced alternatives and do not allow recommendations or use transaction-based compensation." However, based on the widespread criticism of variable annuities sales practices, including by FINRA, these products actually deserve ***more*** supervision, not less.

The North American Securities Administrators Association ("NASAA") has been highly critical of variable annuities. NASAA placed variable annuities on its list of the "Unlucky 13" investor traps[2] and often lists them in its annual Top Ten investment scams. In 2005, the California Department of Corporations placed these products at #2 for their "Dirty Dozen" investment scams.[3]

FINRA has expressed concerns about variable annuities numerous times throughout the last decade. For example, NASD Notice to Members 99-35 discusses the lack of liquidity of variable annuities due to their surrender charges for early withdrawals, and warns registered representatives about the unsuitability of these products for many investors.

NASD Notice to Members 00-44 also emphasized concern about variable annuity sales.

NASD Notice to Members 04-45 warned that variable annuities are complex investments and should not be sold to unsophisticated customers. This notice cataloged numerous disciplinary actions involving variable annuity sales abuses.

Other Notices to Members, including 96-86 and 07-43, alerted members and associated persons to be careful when recommending variable annuities to customers. The NASD's May 27, 2003 and March 2, 2006 Investor Alerts are further examples of the SRO's continuing concern with these products.

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[2] *See* http://www.nasaa.org/nasaa_newsroom/current_nasaa_headlines/4240.cfm (last visited June 12, 2008) (stating that "Variable annuities are only suitable for a very small percentage of the investing public and generally are not appropriate for most seniors").

[3] *See* http://www.corp.ca.gov/press/pdf/2005/nr0503.pdf (last visited June 12, 2008).

FINRA's repeated warnings to its members concerning problems in variable annuity sales have failed to curb the widespread abusive sales practices. As a result, FINRA recently adopted Rule 2821 imposing explicit and more stringent sales practice standards and supervisory requirements for these products. FINRA now seeks to relax the members' supervision of these products as required by Rule 2821. This is simply unacceptable.

II. Limiting the Application of Rule 2821 to "Recommended" Transactions Creates a Loophole for Brokers to Abuse the System

Rule 2821 as originally adopted applied to all deferred annuity purchases. The proposed amendment to NASD Rule 2821 would limit the rule's application to ***recommended*** annuity purchases and exchanges. Unsolicited variable annuity purchases would have very little supervision; indeed, under the proposed revisions there would be no principal review whatsoever.

An obvious threshold concern with FINRA's proposal is that a broker, seeking a large commission where suitability issues are present, may easily mark an order as non-recommended when in fact the transaction was recommended. FINRA recognized this flaw in its proposal.

The SEC release states that "FINRA emphasizes . . . that members must implement reasonable measures to detect and correct circumstances when brokers mischaracterize recommended transactions as non-recommended." Thus, FINRA acknowledged that a broker's simply mismarking the confirmations and orders as "not recommended" would allow these sales to pass with reduced supervision. This creates great potential for abuse, particularly since there would be no required principal review of the claimed non-recommended variable annuity transactions. For a financial product which has received so much criticism for unsuitable sales, misleading terms, commissions, and fees, the amendment provides too much room for abuse by brokers and gives them a loophole to bypass meaningful supervision, merely by designating a sale as "not recommended."

FINRA comments in the SEC release state the purpose of the rule is to keep costs low, especially for firms that offer low-priced alternatives. FINRA adds that the "vast majority of purchases and exchanges of deferred variable annuities" are recommended by the broker. If that is indeed true, then it should not be materially more expensive to supervise ***all*** – recommended and non-recommended – variable annuity transactions. Supervision of all transactions adds relatively low incremental cost.

FINRA states in its explanatory material that limiting principal review of variable annuity transactions to "recommended" transactions tracks with FINRA's general suitability obligation in Rule 2310. FINRA ignores that the "Know Your Customer" rule of NYSE Rule 405 imposes extensive supervision responsibilities without any limitation to "recommended" transactions. Furthermore, FINRA's reference to the general suitability obligation of Rule 2310 ignores the experiences of the past decade which have compelled stringent standards to address widespread variable annuity abuses and which have set these products apart from general securities.

PIABA believes FINRA rule proposals should place investor protection above the industry's objective for minimizing its supervisory burden. Accordingly, PIABA opposes any reduction in the coverage and scope of the suitability rules as they apply to deferred variable annuity transactions.

III. The Proposed Rule Affords No Protections Against Unsuitable Subaccount Reallocations

PIABA also emphasizes its concern that Rule 2821 as originally adopted applies only to ***"initial"*** subaccount allocations and that this provision is left unchanged in the proposed amendment. This leaves brokers free to make subsequent subaccount reallocations with little or no supervision. Changes in the allocation of the subaccounts of variable annuities (as well as additional deposits in the annuities) are just as important to investors as the initial allocation.[4] Some brokers make it a practice to reallocate the subaccounts quarterly or yearly. Allowing brokers to reallocate annuities without principal review is a recipe for disaster and is another example of compromising investor protection for the convenience of the brokerage industry.

Brokers have different incentives for making various subaccount allocations. For example, a broker may get higher fees or commissions for having a higher allocation of stocks or stock-based mutual funds than fixed income or cash investments. A broker can simply reallocate the variable annuity at any point after the initial purchase to create the most fees or commissions for himself or herself, and this would go completely unchecked. Under the proposed rule, the broker is free to ignore investor suitability determinations after the initial purchase.

While we recognize that the question of applying Rule 2821 supervisory standards to subaccounts was not addressed in the proposed rule, PIABA believes

[4] *See* Notice to Members 00-44.

that such a provision is essential to investor protection and that the amendment should be modified to include this provision.

IV. One of the Few Positive Changes to the Proposed Rule Is Weakened by the Supplementary Materials

PIABA supports the change to 2821(b)(1)(B)(iii). The current rule states when making suitability determinations for exchanges, the broker must take into consideration whether an exchange has been made in the customer's account within the last 36 months. The proposed rule deletes the word "account" from that section, effectively changing the rule to mandate the broker to consider whether the customer – in any account – had an exchange within the last 36 months. PIABA believes this is a positive step.

Unfortunately, this language is weakened by the Supplementary Materials. Under Supplementary Materials Section .05, the broker must determine whether the customer had any exchanges at the same brokerage firm, which should be accomplished rather easily. However, according to Section .05, the broker's "reasonable effort" in determining whether exchanges have been made at ***other*** brokerage firms is limited to asking the customer.

Many financially unsophisticated customers may not understand whether or not they have had exchanges. The broker will be relying on those who cannot always be expected to give accurate information about their exchanges. Although it is certainly commendable that brokers are required to document their inquiry and response from the customer under Section .05, the brokers' source of information may be too unreliable.

Conclusion

The proposed amendment to Rule 2821 is a regrettable attempt by FINRA to weaken the standard of supervision for variable annuities essential for investor protection. The importance of preserving the provisions of Rule 2821 as adopted is demonstrated by the pattern of industry abuse in marketing these investments. We therefore urge rejection of the proposal; however, we support the provision expanding the suitability consideration to exchanges in accounts other than the

account in which the purchase is made. We also support an amendment to Rule 2821 that would apply its supervisory standards to subaccount reallocations.

Respectfully,

PUBLIC INVESTORS ARBITRATION
BAR ASSOCIATION

s/Laurence S. Schultz
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President, 2007-2008

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