Northwestern Mutual Investment Services, LLC

September 16, 2005

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

Re: File Number SR-NASD-2004-183

Dear Mr. Katz:

The Northwestern Mutual Life Insurance Company (the "Company") and its broker-dealer subsidiary, Northwestern Mutual Investment Services, LLC ("NMIS"), appreciate the opportunity to comment on a rule initially proposed last year by the National Association of Securities Dealers, Inc. ("NASD") and submitted for the second time to the Securities and Exchange Commission (the "Commission") for review and approval this past July. The proposed rule, which would be codified in the NASD's Conduct Rules as Rule 2821 (the "Proposed Rule") would impose special requirements on certain transactions involving deferred variable annuities.

The Company, as a mutual company, exists for the benefit of its policy owners and clients. Begun in 1857, the Company presently leads the U.S. in total individual life insurance dividends paid to policy owners and, as of the end of 2004, had over 357,000 annuity contracts worth nearly $12 billion. The Company has always received the highest available ratings for financial strength from the four major rating agencies: Standard & Poor's, Moody's Investors Service, Fitch Ratings, and A.M. Best.

NMIS was organized in 1968 and is wholly owned by the Company. NMIS offers a full range of securities products and services and is registered as a broker-dealer in all 50 states and the District of Columbia. NMIS has over 8,000 registered representatives, most of whom are also full-time insurance agents of the Company who sell traditional insurance products including life insurance, annuities, disability income insurance and long-term care insurance. Sales of mutual funds and proprietary variable insurance products make up most of NMIS's business.

Although the Company and NMIS share the NASD's concerns about the inappropriate sales practices referenced in the July 19 proposing release,[1] we have serious reservations about several elements contained in the present version of the Proposed Rule. The proposal places significant burdens on insurance companies, without adequately explaining why the current

[1] Release No. 34-52046A; File No. SR-NASD-2004-183 (July 19, 2005), 70 Fed. Reg. 42,126 (July 21, 2005) ("Proposing Release"). *See also* NASD Notice to Members 04-45 (June 2004) ("NtM 04-45); Joint SEC/NASD Staff Report on Examination Findings Regarding Broker-Dealer Sales of Variable Insurance Products (June 9, 2004) ("Joint Report").

framework for regulating variable product sales practices is inadequate for the purpose of protecting investors. Even more seriously, the Proposed Rule could serve to limit the public's access to an investment product that is uniquely situated to meet the needs of investors – many of whom can no longer rely solely on Social Security and traditional pension plans as their primary source of financial security in retirement.

In seeking to impose new requirements solely on transactions involving deferred variable annuities, the Proposed Rule appears to be premised on the mistaken belief that such products can rarely, if ever, be a valuable component of an investor's financial portfolio. On the contrary, for consumers who want to insure their financial security by guaranteeing that they do not outlive their retirement income, variable annuities are an excellent choice.

Much of the Proposed Rule merely refashions requirements that already apply under the NASD's current Conduct Rules, including Conduct Rule 2310 (Recommendations to Customers (Suitability)), Conduct Rule 3010(d)(1) (Review of Transactions) and Conduct Rule 3110 and IM 3110-1 (Customer Account Information).[2] To this extent, we urge the Commission to re-consider whether investors might be better served by having the NASD issue new interpretive material under the existing rules – an approach which could be less anti-competitive and otherwise preferable to adopting an entirely new rule only for deferred variable annuities. The NASD already has proven through successful enforcement actions that this rule is not necessary to provide it with the authority to sanction wrongdoers. Nevertheless, should a product-specific rule be adopted, we have the following specific objections to the Proposed Rule in its present form.

A. Recommendation Requirements

Subsection (b) of the proposed rule ("Recommendation Requirements") is essentially a restatement of existing requirements. Rule 2310(a) already requires members to have reasonable grounds for believing that all recommendations to purchase, sell, or exchange any security are suitable. Furthermore, Rule 2310(b) requires a member to make reasonable efforts to obtain information about the customer's investment objectives and other information needed to make suitable recommendations regarding any security. It hardly seems necessary – in the interest of protecting investors – to issue new suitability rules applicable to only this kind of security.[3] Beyond this general objection, we believe a number of specific provisions of the proposal are problematic and should be clarified, modified, or omitted if the Proposed Rule is ultimately adopted:

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[2] We assume the NASD intends the proposed rule to apply instead of the existing rules where deferred variable annuities are concerned. It would be helpful if this intention were clarified.

[3] The only other product-specific suitability test imposed the NASD outside Rule 2310 applies to products that are significantly more volatile and involve much greater risk, such as options, currency warrants, index warrants, and securities futures. *See* Rules 2860 and 2865. Once again, we are unclear why the NASD views existing rules as insufficient tools.

1. Subsection (b)(1)(A) – This subsection requires that members and their associated persons have a reasonable basis to believe that the customer has been informed of the material features of the deferred variable annuity. As a practical matter, this language adds nothing not already required by Rules 2110, 2120, IM-2210-2, IM-2310-2 and 3010. In addition, requiring investors to be informed of an undefined list of "material" features of the contract casts doubt on the ability of both brokers and investors to rely on the same disclosure in the contract prospectus.[4] However, even if such a duty were to be imposed, it would be helpful to clarify what is sufficient to support a "reasonable basis."

2. Subsection (b)(1)(B) – This subsection states a requirement that the customer must have a "long-term investment objective." Attempting to codify the guidelines issued in Notice to Members 99-35 ("NtM 99-35") introduces an element of rigidity that presents potential problems of interpretation in special cases and ignores the development and growth of front-load and no-load variable annuities. Perhaps a better approach would be to replace "long-term investment objective" with language referencing an investor's liquidity needs, time horizon, and investment objectives – factors already mandated to be a part of any suitability analysis.

3. Subsection (b)(1)(C) – We believe the Proposed Rule's requirement that a customer must have "a *need* for the features of a deferred variable annuity *as compared with other investment vehicles*" (emphasis supplied) is both unnecessary and unworkable. We take little solace from the statement tucked in a footnote that this would "not require members to perform a side-by-side comparison of the deferred variable annuity with other investment vehicles."[5] On the contrary, the two statements cannot be readily reconciled. We are left uncertain as to what would be required – particularly given the strict requirements the NASD already has in place for product comparisons[6] – and given the changing "needs" of customers over time.

Beyond that, we have a fundamental objection to any requirement that would force a broker-dealer's suitability analysis to shift, *for this product only*, from the "suitable" toward the "perfect." Nothing in the Proposing Release suggests that the NASD has shown the "problematic sales practices" to be so severe that deferred variable annuities as a class deserve to be subjected to such a level of pre-sales review.[7] If this subsection is to remain in the rule at all, it should be revised to place deferred variable annuities on a par with other securities – perhaps by simply adding the words "or desire" after the word "need." This slight change would also prevent a flood of spurious post-hoc

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[4] Proposing Release at 42,128, n.15.
[5] Proposing Release at 42,129, n.20.
[6] *See, e.g.*, NASD Conduct Rule 2210(d)(2)(B).
[7] For example, no showing has been made that although the absolute number of enforcement actions involving deferred variable annuity sales practices may have increased in the last decade, that there has been an actual increase in the number of enforcement actions when measured against the tremendous growth of assets invested in deferred variable annuities made by millions of satisfied investors over that same period.

claims and endless hindsight analysis of the meaning of the concept of "need" in reference to various investment vehicles. In the alternative, the Commission could provide greater clarity on what is meant by "need," when it must be measured, and by whom. If such clarity is not given, issuers could be subject to a patchwork of different interpretations of "need" in each of the NASD's district offices.

4. Subsection (b)(2) – This subsection requires members and their associated persons to obtain certain minimum suitability information. Although virtually the same guidance appeared in NtM 99-35, the proposed rule contains several seemingly arbitrary, unexplained variations. Also, shortly after NtM 99-35 was published, the Securities and Exchange Commission promulgated Rule 17a-3(a)(17)(i)(A) of the Exchange Act, which created a similar, but not identical, list of minimum customer account record requirements and which also applies to member firms under Rule 3110(a). We urge the Commission to consider whether there is some clear benefit to investors for mandating yet another list of minimum suitability information that outweighs the significant additional costs for what appears to be largely a redundant requirement that could be perceived as a further invasion of customer privacy.

This subsection (b)(2) also requires suitability determinations to be documented and signed by the associated person recommending the transactions, in addition to being approved by a registered principal, as required by paragraph (c) of the new rule. To the extent this requirement is a restatement of what Rules 2310, 3010(d)(1) and 3110(c)(1)(C) already require, it is unnecessary. To the extent it requires more, it appears arbitrarily to tilt the playing field away from deferred variable annuities.

B. Principal Review and Approval

The most recent version of subsection (c) of the Proposed Rule ("Principal Review and Approval") is markedly different than the original version of the rule as it appeared in NtM 04-45 and from the version that was initially submitted to the Commission in December 2004. As it presently stands, the Proposed Rule would prohibit registered representatives or broker-dealers from transmitting variable annuity contract applications to the issuing insurance company until after a registered principal has reviewed and approved the transaction. We strongly object to this pre-approval requirement, as it places an undue (and unjustified) burden on the sales process of a deferred variable annuity. Such a requirement also fails to take into account the practical operations of an insurance company with a captive broker-dealer, where the registered principal may well be housed in the insurance company itself. In addition, such a rule would require an enormously difficult and costly change in our processing systems – systems on which we have already spent considerable resources in light of NtM 99-35.

Subsection (c) would require principals to perform their own suitability analysis of a deferred variable annuity transaction, incorporating many of the same problematic elements described above along the same flawed lines as described above in subsection (b), and regardless of whether the transaction is recommended. This places the principal in the position of regularly

"second-guessing" representatives with firsthand knowledge of the customer. Worse yet, in cases involving transactions where no representative is involved, it suggests that the principal must substitute his or her own judgment for that of the customer. This requirement in subsection (c) also appears not only to go well beyond the requirements of Rule 2310, but also to be in direct conflict with Rule 2820(d), which requires members to forward "promptly" variable contract payments after receipt by a member. The drafters of the Proposed Rule, in our view, have not taken into account the practical difficulties that would be created if this principal pre-approval requirement is imposed.

It is not clear to us whether the Proposed Rule would apply to subsequent purchase payments made under a deferred variable annuity contract, which are most often not "recommended" by a registered representative, but made pursuant to the terms of the contract. We request that the Committee clarify that such transactions are not required to comply with the Proposed Rule.

Thank you for the opportunity to comment. If you have any questions, please contact me at (414) 665-3823.

Very truly yours,

Daniel A. Riedl,
Senior Vice President and Chief Operating Officer,
Northwestern Mutual Investment Services, LLC

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