

VIA ELECTRONIC MAIL

September 19, 2005

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

Re: File Number SR-NASD-2004-183

Dear Mr. Katz:

The Financial Services Institute¹ ("FSI" or "the Institute") appreciates this opportunity to comment on Amendment No. 1 to SR-NASD-2004-183 ("Proposed Rule") filed by the National Association of Securities Dealers, Inc. (NASD) on July 8, 2005. NASD is proposing to adopt a new rule, Proposed Rule 2821, to create recommendation requirements (including a suitability obligation), principal review and approval requirements, and supervisory and training requirements tailored specifically to transactions in deferred variable annuities ("DVAs").

The Institute agrees that these products have many features that make them complex investments. We applaud the NASD's effort to enhance investor education and protection. We support in principle the concept of adapting the existing best practices guidelines into a rule that would uniformly apply across the industry. However, the Proposed Rule would go further by imposing significant new burdens on broker-dealers. We believe there are options that could address the perceived problems relating to the offer and sale of variable annuities in a more effective and cost-efficient manner than the Proposed Rule. We would respectfully urge the NASD and the SEC to consider these preliminary steps before more costly and burdensome obligations are imposed. We also strongly believe that the insurance industry must be a significant part of this rule-making process for the outcome to be truly meaningful to the investing public.

Our specific comments on the Proposed Rule are outlined below.

Comments on the Proposed Rule

- A. Specific Suitability Standards - Paragraphs (c) and (d) of the Proposed Rule require broker-dealers to establish certain specific suitability standards to be applied in connection with their supervisory review. For example, paragraph (c) provides that a principal shall consider, in their review of a specific transaction, the appropriateness of a sale: (1) to a

¹ The Financial Services Institute is the voice of independent broker-dealers and the independent financial advisors they serve. FSI has 100 member firms (91 broker-dealers and 9 consultants), with more than 122,000 registered representatives and over \$8 billion in Total Revenues.

customer over a certain age; and (2) where the amount being invested exceeds a stated percentage of the customer's net worth or is more than a stated dollar amount. In each case, the member must establish its standards for "certain age", "stated percentage" and the "stated dollar amount." We are very concerned that these standards are not defined or specified in the Proposed Rule and, therefore, our members will be second-guessed when they attempt to do what they believe is reasonable in light of their unique business model. Also, by specifically stating the standards in the rule, the NASD will avoid the inevitable consequence that different NASD districts will establish and impose their own standards, which will likely vary from district to district.

Finally, the Proposed Rule's requirement for specific suitability standards fails to recognize the sheer variety of DVA product offerings. We have seen in recent years the development of "no load" DVA products and products offering "living benefit" riders and other features which make these investment vehicles attractive to new classes of investors. In light of the significant and ever increasing diversity of DVA product offerings, the Proposed Rule's specific suitability standards requirement appears unworkable.

- B. Time Horizon - Paragraph (b)(1) of the Proposed Rule provides that a broker-dealer may not recommend the purchase, sale, or exchange of a DVA unless it has a reasonable basis to believe, among other things, that the customer has a "long-term investment objective." This language would permit the NASD to take the position that it is per se unsuitable to recommend a DVA to any customer who meets all of the other suitability criteria except that he/she does not have a "long-term investment objective." Further, the Proposed Rule fails to recognize that the features and benefits of some DVA product offerings would not require a customer to have a "long-term" time horizon. As a result, FSI believes that time horizon should be only one factor in determining suitability and it should be measured on a case-by-case basis in light of the DVA's features and the customer's other investment objectives and needs. We cannot think of any other product with respect to which either the SEC or NASD has taken such a one dimensional approach to suitability determination. As such, we believe the NASD should include time horizon as one of the suitability criteria listed in Paragraph (b)(2) of the Proposed Rule. Alternatively, if the NASD does intend for time horizon alone to be the determinate of whether a recommendation can be made, the NASD must define what it means by "long-term investment objective" so that broker-dealers will have a clear standard to apply to DVA transactions.
- C. Product Specific Suitability Criteria - Paragraph (b)(2) of the Proposed Rule provides that a member must make reasonable efforts to obtain certain product specific suitability information about the customer prior to recommending a DVA purchase or exchange. Although we support the NASD's listing of specific suitability criteria necessary to support a recommendation, we are concerned that certain product specific criteria listed by the NASD are either unclear or irrelevant to a suitability determination. For example, what constitutes a legitimate "intended use of the DVA?" Is either estate planning or tax deferral a legitimate "intended use" or would the NASD require a more detailed analysis? Similarly, to what extent does the NASD expect "existing investment and insurance holdings" to bear on the suitability determination? If the customer owns a life insurance policy, will the NASD determine that a DVA is unsuitable?

We are most concerned by the fact that the NASD believes it has to go far beyond the suitability criteria contained in its general suitability rule (Rule 2310) to establish a

product specific suitability rule directed only at DVAs. The only other product specific suitability test imposed by the NASD outside Rule 2310 applies to options, currency warrants, index warrants and securities futures (see Rules 2860 and 2865). The suitability standards for securities futures described in Rule 2865 are not as onerous as those proposed by the NASD for DVAs. The establishment of a new suitability rule for DVAs is unwarranted. If Rule 2310 provides satisfactory suitability standards for all other products except the volatile, high-risk products mentioned above, it should be appropriate for determining the suitability of DVAs. If the NASD believes that additional product-specific suitability criteria should be applied to DVAs, it should develop those criteria through discussions with manufacturers and distributors of these products. It should ensure that the criteria are clear and can be applied uniformly, and either add the product specific criteria by amending Rule 2310 or add the criteria by Interpretative Memoranda ("IMs").

- D. Training - Paragraph (e) of the Proposed Rule requires members to develop and document training policies and programs designed to ensure that associated persons who sell and supervise DVAs understand the general material features of the products, including liquidity issues, sales charges, fees, and market risks. FSI strongly supports this component of the Proposed Rule. These are complex products, their features and internal costs vary widely. This makes it difficult for many registered representatives ("RRs") to fully understand product features, to ensure product features fit a client's specific needs, and to explain to customers in a manner they can understand. We appreciate the fact that these products may have been sold by RRs who did not fully understand all of the features, costs and risks associated with the particular product they recommended. We also acknowledge that some of these transactions may have been approved by supervisors who also did not fully understand the general product features and limitations.
- E. Disclosure – The Institute supports the NASD's effort, as discussed in Notice to Members 04-45, to provide customers with better, more meaningful disclosure. For example, FSI supports the addition of a "plain English" summary discussion of and Q&A on product features and risks at the beginning of the prospectus that links to a more detailed discussion of each item in the body of the prospectus. We believe that a "plain English" summary of risks and features combined with a Q&A that covers commonly misunderstood or confusing issues would encourage customers to read at least those portions of the prospectus that are most meaningful to their investment decision. To maintain accuracy and consistency, the disclosure must be developed by the product issuers, not the broker-dealers who sell the product.
- F. Duplicative State Insurance Regulations - The Proposed Rule states that broker-dealers can use existing state insurance exchange or replacement forms "to the extent that the regulatory agency's form requires disclosure of the information required by NASD's proposed rule." This would require broker-dealers to constantly monitor minor changes in state regulations to ascertain if they cover the identical information as the Proposed Rule. This could require that an investor receive two exchange or replacement forms where a state deviated from the NASD's forms. This appears to be an overload of disclosure documentations and detracts from the prospectus.
- G. Unintended Consequences - FSI recognizes that there have been some serious abuses involving the sale and exchanges of DVAs, although NASD has not provided any hard

data to show the extent of such abuses in view of the total number of products sold. We do not believe the sales abuses have occurred because the NASD's rules and enforcement mechanisms were not strong enough to prevent them. The NASD has determined that the costs and the complexities of these products may outweigh the benefits they can provide to customers under any set of circumstances. FSI disagrees. FSI believes that training and education of RRs and supervisors and more meaningful disclosures to customers will ultimately eliminate most sales practice abuses. FSI is concerned that Proposed Rule 2821 will have substantial unintended consequences. The changes could ultimately harm customers by making DVAs less available to those who need them as legitimate tax-deferred savings and estate and retirement planning tools.

Again, thank you for the opportunity to comment on the Proposed Rule. Should you have any questions, please contact us at 770 980-8487.

Respectfully submitted,



Dale E. Brown, CAE
Executive Director & CEO

pc: Honorable Christopher Cox
Honorable Cynthia A. Glassman
Honorable Paul S. Atkins
Honorable Roel C. Campos
Honorable Annette L. Nazareth
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