September 23, 2005

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Securities America

Re: Amendments to Proposed NASD Conduct Rule 2821—File Number SR-NASD-2004-183

Dear Mr. Katz:

Securities America, Inc. ("SAI") appreciates the opportunity to comment on the NASD's amended proposal to adopt Proposed Rule 2821, which includes new recommendation and suitability requirements, principal review and approval requirements, and supervision and training requirements tailored specifically to transactions in variable annuities ("VAs").

While SAI agrees that VAs should be sold in a suitable manner, SAI has concerns with the proposed recommendation and suitability requirements. Our concerns and some alternatives for consideration will be addressed below.

General Comments

VAs are complex financial instruments and we support the NASD's efforts in the past to enhance investor education and protection in this area[1] While VAs are complex, they can also offer investors with unique features not found in other investment products. Key among these features is annuitization, which allows investors to receive a stream of income payments for life. This feature can be especially valuable to retirees who are concerned about the possibility of outliving their assets. Additionally, there are a number of other benefits that are applicable to VAs, including guaranteed death benefits, long-term care benefits, and the ability to contribute unlimited funds to an investment vehicle that offers the potential for tax-deferred growth. Recently, several living benefits have been added to new products. In 2003, 75% of new contracts sold offered one or more

[1]For example, Variable Annuities and Variable Life Products: Questions to Ask; http://www.sec.gov/investor/pubs/varaquestions.htm; Variable Annuities: What You Should Know; http://www.sec.gov/investor/pubs/varannty.htm; NASD Investor Alert, Beyond the Hard Sell; http://www.nasd.com/Investor/Alerts/alert_variable_annuities.htm; NASD Investor Alert, Should You Exchange Your Variable Annuity? http://www.nasd.com/Investor/Alerts/alert_annuityexchanges.htm; NASD Investor Alert, Should You Exchange Your Life Insurance Policy? http://www.nasd.com/Investor/Alerts/alert_exchange_lifeinsurance.htm; NASD, Equity Indexed Annuities – A Complex Choice; http://www.nasd.com/Investor/alerts/indexed_annuities.htm; NASD, Investing in a 401(k) – an Investment Menu; http://www.nasd.com/Investor/Smart/401k/investing_401k/inv1_1j.html; NASD Investor Alert, Betting the Ranch: Risking Your Home to Buy Securities http://www.nasd.com/Investor/Alerts/alert_betting_ranch.htm

Securities America, Inc. • 7100 West Center Road • Suite 500 • Omaha, NE 68106-2798 • (800) 747-6111 • (402) 399-9111
web address: securitiesamerica.com
Member NASD/SIPC

types of living benefits.[2] Such living benefits include, but are not limited to guaranteed minimum accumulation benefits that guarantee the contract value will be at least equal to a certain minimum amount after a specified number of years, guaranteed minimum income benefits that guarantee that annuity payments will be based on the greater of the contract value or a minimum payout base, and guaranteed minimum withdrawal benefits that guarantee the systematic withdrawal of a certain percentage (such as 5-7%) of premiums annually until premiums are completely recovered.

Specific Concerns With The Proposed Rule

While the NASD contemplates adopting the Proposed Rule 2821 as amended on July 8, 2005, we respectfully encourage you to consider the following comments and proposed changes to this rule. We believe that our proposed changes offer needed flexibility for members, while offering enhanced protection to the investor as well. In particular, the provisions of the proposed rule that are of most concern to SAI are contained within the proposed recommendation and suitability requirements under Proposed Rule 2821(b).

As proposed, the new rule requires a member or associated person to have a reasonable basis for believing that 1) the customer has been informed of the material features of the deferred VA; 2) the customer has a long-term investment horizon; 3) the customer has a need for the features of a deferred VA, as compared with other investment vehicles, and 4) that the deferred VA as a whole and the underlying sub accounts to which the premiums are allocated at the time of the purchase or exchange are suitable for the customer. As currently proposed, all of the four requirements mentioned above must be satisfied before a member or associated person can have a reasonable basis for recommending a VA to a customer.

Of particular concern is the requirement that the customer must have a long-term investment horizon. While it is true that this requirement is prudent in many cases, there are other situations where the requirement seems unnecessary.

For example, some variable annuity products have short-term surrender charge schedules while other contracts offer complete liquidity to funds with no surrender charges at any time. Also, investors who have already reached the age of 59 ½ at or near the time of sale can take distributions from their annuity without incurring a 10% income tax penalty. Additionally, many annuity products offer investors the ability to take an early withdrawal without incurring surrender charges. Assuming the investor has already reached age 59 ½ and can withdraw money without incurring a surrender charge, it would be unnecessary to require the investor have a long-term investment horizon.

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[2] "Overview of the Variable Annuity Market," by Michael P. DeGeorge, JD, Vice President and General Counsel of the National Association for Variable Annuities. As presented in "Making the Suitable Sale: The NASD Requirements for Variable Annuities." February, 2005.

There are other circumstances where a long-term investment horizon may be unnecessary. For example, an investor may buy an annuity with the expectation that if a better product comes along in the future (perhaps five years, for example), he may switch to that product. This is not inherently problematic considering that as the variable annuity has advanced along its product life-cycle, the industry has witnessed a product proliferation to meet a wide array of customer demands.[3]

As a practical matter, annual fees charged for administrative costs, mortality charges, and investment management fees vary widely among products. These charges can vary anywhere from as high as 300 total basis points to as low as 65 basis points in cases where non-load products are purchased.[4] In view of this, it is certainly conceivable that an investor of senior age might want to reduce his or her overall fees by exchanging into a product that has a track record for charging substantially lower fees. This investor might also be willing to purchase a product with a new surrender period.

It is also important to keep in mind that insurance companies, broker-dealers, and registered representatives have been working together to bring value to customers by creating products, enhancements, and riders in response to investor demands. Cynthia A. Glassman, of the U.S. Securities and Exchange Commission in a recent speech stated:

> "Competition has had a positive impact on the annuity industry in terms of fostering innovation in product development. Variable annuity products have changed rapidly over recent years in response to competitive pressures and client demands. As a result, the products can now include a wide array of features that were not available only a few years ago. These innovations are driven by the market, and if sold appropriately can help meet investors' financial planning needs."[5]

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[3] Key reasons for why many people incur surrender charges are 1) poor performance of investments; and 2) lack of suitable investment options. *See*, Variable Confusion, Registered Rep (Sept. 1, 1998).

[4] *See, e.g.*, Variable Confusion, Registered Rep (Sept. 1, 1998) (pointing out the wide range of fees charged by insurers); *See also,* JWA Financial Group, Retail vs. No-Load Variable Annuities (2005) (pointing out that fees charged for no-load VAs tend to be substantially lower and are often sold by investment advisor representatives that receive their compensation from investment management fees).

[5] Speech by SEC Commissioner: Remarks before the National Association of Variable Annuities by Cynthia A. Glassman; Washington, D.C.; June 14, 2004; available at: http://www.sec.gov/news/speech.shtml.

Although Ms. Glassman notes that competitive pressures can also result in potentially unfavorable effects, SAI believes that the net effect to consumers of increased competition and greater product choice is positive.

Of course, all of this begs the question as to what a long-term investment horizon really is. Does this mean that VAs can never be sold to retirees or customers who are nearing retirement? Does this mean an investment horizon that exceeds 10 years or more? Or, does it mean an investment horizon that simply exceeds the applicable surrender period on the replacement VA? Unfortunately, the proposed rule offers no guidance on this question.

An Alternative Suitability Rule

In view of what has been said so far, we would encourage a suitability requirement that requires the member firm or associated person to have a reasonable belief that 1) the material features of the VA have been prominently disclosed, and 2) that the VA and underlying sub-account allocations are suitable under the circumstances. To clarify the suitability requirement, the immediately-following sentence of the rule should then offer a list of suitability factors that **must be considered** by the member firm or associated person when making a recommendation of a VA product. This list of suitability factors would need to include a careful examination of the following circumstances: whether the customer's investment horizon is long-term in nature; if the customer's investment horizon is not long-term, whether there are other considerations to justify the recommendation; whether the customer has a stated preference for the VA features as compared with other investment products; the customer's liquidity needs; whether the customer's investment exceeds a stated percentage of the customer's net worth; whether the investor will incur surrender charges in completing the transaction; whether the surrender schedule of the replacement VA exceeds that of the relinquished product; whether the investment option, fees and contract charges of the replacement product are competitive when compared to that of the relinquished product; and whether there is a reasonable danger that the customer's investment in the relinquished product will be compromised as a result of insurer default or insolvency.

Please note that a number of the suitability factors mentioned above are actually taken from the same standards set forth in proposed Rule 2821(c), which addresses the principal review and approval requirements. This provides an element of consistency among the recommendation and principal approval standards set forth in the proposed rule.

Other Comments—variable annuity fees: addressing public perceptions

A common perception among the public is that variable annuities are too expensive and sales result in excessive commission payments to representatives who in turn are perceived to be more likely to push these products over others. This sentiment is reflected in numerous financial articles and other media.[6]

Notwithstanding this perception, there have been initiatives taken by a number of prominent financial companies to offer VA products with relatively low annual fees. Additionally, we should be mindful that many VAs were purchased back in the 1990s, a time when market movements were increasing at record levels.[7] One such alternative explanation was offered by Bankrate.com:

> " . . . Craig Israelsen is professor of consumer and family economics at the University of Missouri-Columbia, and author of the book, *The Thrifty Investor: Penny-Wise Strategies for Investors on a Budget*. He notes that the increase in **[variable annuity]** sales also can be attributed to the activity of monster mutual fund companies such as Vanguard, Fidelity, T. Rowe Price and TIAA-CREF, which offer the annuities at lower costs. TIAA-CREF, for instance, doesn't charge a surrender fee and keeps total expenses at between .37 and .39 of the account balance."
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> "The big, big hitters started to introduce annuities eight to 10 years ago," he says. "They have enormous market presence because they have a huge clientele that invest in mutual funds. They come in and sell huge volumes and do not take as big a cut. That's clearly Vanguard's perspective. That was good for consumers; it provides competition for insurance companies."

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[6] Variable annuities are being touted as new and improved. But they still cost too much. FORTUNE Monday, October 4, 2004 By Janice Revell, located at http://www.fortune.com/fortune/subs/print/0,15935,709089,00.html; Smart Money.com, What's Wrong With Variable Annuities, http://www.smartmoney.com/retirement/investing/index.cfm?story=wrongannuities updated 8/5/2005; *See also*, Milberg Weiss, Variable Annuities: The Venus Fly Trap of Investments (2005) (claiming VAs pay commissions 2-20% higher than mutual funds); Wall Street Journal, How Variable Annuities Can Gnash Investors (Feb. 6, 2004) (asserting that VA commissions can run as high as 10% of an initial investment); It's Top Ten Time Again-Regulators Identify This Year's Top Ten Investment Scams, StockPatrol.com (Jan. 27, 2004) (claiming high commissions are the driving force for sales of variable annuities); Paul Wenske, Annuity Nightmares, nwitimes.com (2005) (asserting that many investors are not told that these complex contracts carry large commissions, hidden fees and steep surrender charges).

[7] *See*, Pat Curry, Why Annuity Sales Have Skyrockets, Bankrate.com (Aug. 7, 2001) (citing Professor Craig Israelsen's explanation for dramatic increases in VA sales in the 1990s)

> "Combine that with the runaway performance of the stock market in the late 1990s, and it's easier to see why investors flocked to variable annuities."

In support of this alternative explanation provided by Bank.rate.com, many investors believe that they have benefited from their VA purchases. According to a survey conducted by the Gallup Organization, 91% of all annuity owners agree that annuities are an effective way to save for retirement.[8]

To address these contrasting perceptions, we suggest that the NASD conduct a study of alternative variable annuity pricing models such as: potential breakpoint options, industry best practices for compensation disclosure, and whether benefits could be achieved through lowering the maximum allowable commission payments for sales of VAs. We believe that a thorough and unbiased review of these possibilities and a detailed explanation of related findings would be beneficial for the industry and the investing public.

Conclusion

As the NASD is inclined to adopt proposed Rule 2821, we respectfully request that the NASD be mindful of the comments and suggestions set forth in this letter. In particular, we would urge the NASD to adopt a recommendation and suitability rule that offers some flexibility and that protects the consumer. Additionally, we recommend that the NASD consider ways to evaluate the need for action in response to the negative public perception of variable annuity fees and compensation practices

Once again, we appreciate the opportunity to submit these comments.

Sincerely,
Securities America, Inc.

David O. Spinar
Vice President and Chief Compliance Officer

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[8] *See,* Mark Mackey's Letter to Editor of the Wall Street Journal (Feb. 6, 2004) (Mr. Mackey is the Chief Executive Officer of the National Association for Variable Annuities (NAVA)).