



September 19, 2005

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

Via Electronic Mail: rule-comments@sec.gov

Re: File Number SR-NASD-2004-183

Dear Mr. Katz:

The National Association of Insurance and Financial Advisors ("NAIFA") and the Association for Advanced Life Underwriting ("AALU") submit this letter in response to the Securities and Exchange Commission's request for comments on the National Association of Security Dealers' ("NASD") Proposed Rule and Amendment No. 1 Thereto Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities (NASD Rule 2821) (the "Proposed Rule").

NAIFA is a national federation of over 700 state and local associations, whose members live and work in every congressional and state legislative district. The 65,000 members of these associations are bound by NAIFA's Code of Ethics and are full time professionals in insurance and related financial services. Founded in 1890, NAIFA is the nation's oldest and largest trade association of insurance and financial services professionals. NAIFA's mission is to enhance the professional skills and promote the ethical conduct of agents and others engaged in insurance and related financial services that assist the public in achieving financial security and independence, and to improve the business environment. A majority of NAIFA members are licensed as registered representatives of broker-dealers and market and service variable annuities, mutual funds and other investment products.

AALU is a nationwide organization of life insurance agents, many of whom are engaged in complex areas of life insurance such as business continuation planning, estate planning, retirement planning, deferred compensation and employee benefit planning. AALU represents approximately 2,000 life and health insurance agents and financial advisors nationwide.

At the outset, NAIFA and AALU would like to commend the NASD for deleting from the Proposed Rule the requirement to provide a separate "risk disclosure document" to the

customer. (This disclosure requirement was included in the initial version of the Proposed Rule which the NASD published for comment in NASD Notice to Members 04-45 (June 2004)). This requirement would have been redundant and overly burdensome, and would not have provided any additional benefit to consumers. This type of disclosure requirement should not be reconsidered or proposed in the future.

While we applaud the deletion of this requirement, remaining provisions in the Proposed Rule are equally unnecessary and overly burdensome. Specifically, the Proposed Rule would impose specific suitability requirements in connection with the sale of deferred variable annuities and supervisory review requirements that require a principal to second guess the agent's advice and recommendations.

In the past several years, the NASD has issued a number of alerts and notices to educate investors and broker-dealers engaged in transactions involving variable annuities. The Proposed Rule is based on a "Notice to Members" issued by the NASD in 1999 (NtM 99-35). NtM 99-35 provided "best practices" guidance to assist broker-dealers in developing procedures relating to the purchase, sale or exchange of deferred variable annuities.

As the Proposed Rule is currently drafted, NAIFA and AALU members who are registered representatives of broker-dealers affiliated with life insurers and who sell variable annuities will be required to comply with the requirements of the rule when it becomes effective. NAIFA and AALU firmly believe that people who engage in unscrupulous or misleading sales practices should be aggressively prosecuted and subject to appropriate and meaningful sanctions. We are forced, however, to oppose promulgation of the Proposed Rule for the following reasons:

- The Proposed Rule's suitability requirement is redundant and would duplicate suitability requirements already in force;
- The Proposed Rule would place the variable annuities industry at a competitive disadvantage by imposing requirements on variable annuities that are not imposed on comparable investment products;
- The Proposed Rule's supervisory approval requirement will cause unnecessary economic harm to broker-dealers, registered representatives and consumers; and
- Available statistics indicate that variable annuities transactions make up a very small percentage of total disciplinary actions undertaken by the NASD.

1. The Proposed Rule's suitability requirements are redundant and would duplicate requirements already in force.

The Proposed Rule would essentially duplicate suitability requirements currently found in the NASD's general suitability rule, Rule 2310, which covers the activities of broker-dealers and their registered representatives. For example, Rule 2310(a) currently requires broker-dealers and registered representatives to "have reasonable grounds for believing that the recommendation is suitable for such customer" based upon the facts of the individual customer's situation. The rule further requires members to make reasonable efforts to obtain information needed to make suitable recommendations, including the consumer's financial status, tax status, and investment objectives.

The provisions of subsection (b) of the Proposed Rule basically restate the requirements already found in Rule 2310, and do nothing to further the goal of consumer protection. The NASD has issued guidance stating specifically that the current suitability rules apply to transactions involving variable annuities (NtM 96-86, 99-35 and 00-44). Adopting a separate rule specifically applicable to variable annuities is unnecessary and redundant. This redundancy would do little to protect consumers and, in fact, could cause confusion and misunderstanding, ultimately leading to less effective consumer protection.

If regulators believe there are abusive practices in the variable annuities marketplace, appropriate enforcement of existing laws and the current NASD suitability rule is the solution, as opposed to the adoption of a new rule. Duplicating existing standards in a new rule is unnecessary and would provide no added protection for consumers.

2. The Proposed Rule would impose requirements on variable annuities that are not imposed on comparable investment products.

The Proposed Rule would impose specific suitability and principal review requirements on the sale of variable annuities, but not on comparable investment products such as mutual funds and real estate limited partnerships. These additional burdens would place broker-dealers, registered representatives and financial institutions that sell variable annuities at a competitive disadvantage in comparison with those who market other types of investments. These requirements, while adding little if anything in terms of consumer protection, could ultimately cause expenses and, therefore, the fees associated with variable annuities, to rise. Higher costs will cause consumers to look to other, less expensive investment products which may not be as appropriate for the consumer's needs. To the extent the other products are favored and have lower compliance costs, they will be less expensive and, thus, be at a competitive advantage as compared to variable annuities. The Proposed Rule provided little if any discussion or analysis of its anticompetitive impact or consequences.

There does not seem to be any logic to this differential treatment. Currently, the general suitability and supervisory oversight rules apply equally to variable annuities as well as other investment products. Singling out variable annuities for additional specific regulation to the exclusion of other investment products is either over-kill or under-protection. The result will simply be to put variable annuities at an economic disadvantage relative to other products such as mutual funds and other types of securities and financial instruments. If the NASD sees a need to adopt specific rules for variable annuities, logic would dictate that it also adopt specific rules for other, comparable investment products.

3. The Proposed Rule's supervisory review requirements will cause unnecessary economic harm to broker-dealers and consumers

Under the Proposed Rule, a registered principal must review and approve every application prior to its submission to the insurance company. This rule is problematic for two reasons.

First, requiring prior review and approval by a principal before submitting the application to the issuing company could substantially delay the completion of the transaction. Supervisors may be out of town or on vacation, and transactions could be stalled for days at a time. Because markets fluctuate, the loss of time could cause loss of value, resulting in economic harm to the consumer. (The one-day turn around requirement contained in the initial draft of the Proposed Rule was equally problematic and unworkable.)

Second, the principal would be required to essentially second guess the registered representative's advice and recommendations by independently determining, prior to submission to the insurance company, the customer's need for the product and whether there was not some other product that would serve the customer's needs just as well. This could expose the broker-dealer, the principal and the registered representative to unavoidable litigation down the road. As we all know, "hindsight is 20/20", and the principal cannot possibly "see the future" or know for certain whether the transaction will ultimately benefit the consumer. However, consumers who do not obtain the desired results will most assuredly bring lawsuits claiming that the principal should have known that the product was not suitable for the customer's situation.

These burdens are unwarranted. Variable annuities should be subject to the same review requirements as are in place for securities in general. There should be no specific requirement that the principal review every application. Further, reviews should be permitted to take place after the fact of the transaction. Imposing stricter requirements creates an unnecessary burden that can only harm consumers, and creates an atmosphere in which supervisors will be pressured to make hasty, overly cautious decisions for fear of future litigation.

4. Despite alleged abuses, statistics indicate that variable annuities make up a small percentage of total disciplinary actions undertaken by the NASD.

Finally, NAIFA and AALU believe that the NASD proposal is a "solution in search of a problem." In its Statement on Burden on Competition, the NASD simply states that it "does not believe that the proposed rule will result in any burden on competition that is not necessary or appropriate..." However, the NASD has failed to provide quantifiable evidence indicating a significant enough problem to justify the burdens imposed by the proposed rule. The available data simply does not support the NASD's claims that the number of sales and marketing abuses in the variable annuity marketplace warrants adoption of specific suitability and supervisory oversight rules governing variable annuity sales. In recent years, the NASD disciplinary actions relating to variable annuities and people who sell variable annuities have constituted roughly 8% of the NASD's total annual disciplinary actions. This is despite the fact that registered representatives working for broker-dealers affiliated with life insurers – that is to say, variable products salespeople – comprise over 50% of the total number of registered representatives. Based upon the objective data, the NASD has failed to demonstrate a need for the Proposed Rule.

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In conclusion, NAIFA and AALU firmly believe that people who engage in misleading sales practices should be aggressively prosecuted and subject to meaningful sanctions. Having

said that, we note that the NASD already has the requirements in place and the tools available to ensure that appropriate and suitable variable annuity products are sold to consumers. The Proposed Rule would unnecessarily duplicate the current requirements and place variable annuity products, and the individuals who sell them, at a competitive disadvantage to other, comparable investment products and their salespeople. If regulators really want to protect consumers, NAIFA and AALU believe the fairest, most effective way to do so is through appropriate enforcement of existing rules and laws.

Thank you for your consideration of our views. Please contact us if you have any questions regarding our comments.

Yours Truly,

/s/ Gary A. Sanders

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