September 16, 2005

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

Filed via e-mail at:
Rule-comments@sec.gov

RE: File Number SR-NASD-2004-183; NASD proposal to adopt a new Rule 2821

Dear Mr. Katz:

We are pleased to respond to the request for comments on the above referenced rule changes proposed by NASD ("the Rule") and published for comment by the Securities and Exchange Commissions ("SEC") relating to new requirements specifically tailored to deferred variable annuities ("Annuities") concerning recommendations, suitability, principal review and approval, supervision and training.

Pacific Select Distributors, Inc. ("PSD") is a broker-dealer member firm of the National Association of Securities Dealers, Inc. ("NASD") and is a subsidiary of Pacific Life Insurance Company. PSD has an affiliate relationship with seven retail NASD member firms ("Firms"). PSD also serves as a distributor of variable contracts and mutual funds offered by Pacific Life Insurance Company and its affiliates. Several of PSD's affiliated retail broker-dealers service and supervise independent contractor registered representatives who provide financial planning and investment advisory services ("Representatives") to their clients.

PSD is concerned about the impact of the Rule on Firms that retail Annuities. The Rule is rooted in NASD Notice to members 04-45 which was published for industry comment over a year ago. It is worthy of note that there were over 1,000 industry comment letters in response to Notice 04-45 the vast majority of which (over 97%) opposed the proposed changes. We commend the NASD for setting aside the point of sale disclosure requirements and narrowing the scope from the original proposal. However, we believe a more appropriate response would have been for the NASD to reconsider the entire proposal and going back to the drawing board with industry input rather than recommending this somewhat abbreviated but still problematic Rule

We strongly suggest that the SEC reject the Rule. After detailing the reasons for rejecting the Rule, we will conclude our comments with suggestions for more practical ways to address any outstanding regulatory issues relating to Annuity transactions.

We believe the Rule, if enacted in its current form, would unfairly discriminate against Annuities and would have negative unintended consequences for Firms and for Annuity investors. Note the following:

1. The Rule, if implemented in its current form, would create an unfair competitive environment for a product line that provides great value to the public. The NASD cites an increased volume of customer complaints as justification for this harsher treatment. We believe that any increase in customer complaints has affected all investment product lines, including mutual funds, and results primarily from market volatility, negative media coverage and increased promotion of litigation by plaintiff attorneys. Further it has been our experience that the number of customer complaints about Annuities has increased at a slower pace than the volume of Annuity transactions. The NASD also cites regulatory enforcement actions as a basis for imposing more restrictions on the sale of variable annuity contracts yet published information indicates that the volume of enforcement actions may be even higher with respect to other product lines such as mutual funds.

2. While the Rule makes no explicit negative statements about Annuities, the imposition of disclosure, supervisory requirements and suitability review requirements more detailed and onerous than that for any other product line (including options, penny stocks, hedge funds and commodity pools) sends a clear, damaging and inaccurate message about Annuities to the financial services industry and the public. Annuities are an increasingly popular investment product line due to an explosion in the number of retirees combined with a substantial reduction in availability of corporate sponsored defined benefit retirement plans. Insurance companies, via Annuity death and living benefits, provide guarantees not available in any other investment products. The growing market for Annuities has spawned competition that results in dynamic product innovation and aggressive pricing which inure to the public's benefit. This positive momentum would probably be sacrificed – to the investing public's detriment - if the Rule were approved making distribution of Annuities more difficult and expensive than alternative investment products.

3. The Rule would create an entirely unique supervisory framework for the sale of variable annuity products at a time when any member firm that takes regulation seriously has already fully engaged its technology and human resources attempting to implement the unprecedented volume of new rules and demands promulgated by regulators over the past 18 months. The proposal, if implemented in its current form, would require that variable annuity business be processed and supervised differently than any other product line, resulting in inefficiency, increased costs and serious erosion of existing compliance and supervisory systems.

4. The Rule requires that a supervising principal ("Supervisor") literally duplicate the Representative's role with respect to every single variable annuity transaction. This is clearly overreaching and creates an unfair exposure to personal civil liability for the Supervisor. The perception created by this Rule provision is that no Representative is capable of determining a

client's suitability for any Annuity transaction. A duplication of the Representative's role would require that a Supervisor have detailed personal knowledge of the customer and sign off on a detailed suitability summary. In the case of an Annuity transaction involving a 1035 exchange, the supervisor would be required to personally review a detailed comparison of old and new contract. A Firm providing access to a large number of variable contracts would be forced to allocate two to three times the supervisory staff for Annuity transactions than for any other product line. Such requirements would result in a substantial diversion of supervisory resources from other important duties and create an unfair financial penalty on any firm that engages in Annuity business.

5. The Proposal's requirement that a Supervisor duplicate the Representative's role in determining suitability of each Annuity transaction also creates an unfair burden on firms with diverse product lines. For example, a Firm that wants to provide maximum flexibility for Representatives and their clients would typically maintain selling agreements with a majority of the 100-plus life insurance companies offering Annuities. Those agreements would likely encompass a universe of over 400 Annuity products. Each individual Representative would normally select a small number of such products that fit their typical client. However, in the aggregate, the Representatives affiliated with a Firm might have occasion to recommend any one of the 400 Annuity products at one time or another. If the Rule were implemented in its current form, the Supervisors of the Firm would have to be familiar in detail with all those products on a moments notice.

6. Meeting the Rule requirement that Annuity applications be held by the firm until a Supervisor reviews and approves each transaction would be unfair to Annuity investors, who have as much right as anyone else to timely execution. Substantial liability may inure to Representatives, Supervisors and Firms due to market value changes during such delays in submitting applications. In the context of most investment accounts holding back customer funds would subject a Firm and/or a Representative to severe penalties.

7. The NASD has included a specific list of suitability factors to be considered with respect to Annuity transactions. In our opinion these factors are not unique to Annuities, but should be considered when designing any investment portfolio whether or not it includes Annuities. A more logical approach would be for the NASD to propose amendments to Rule 2310 and provide a defined checklist of suitability criteria that must be considered for any investments accounts. Again, why have detailed criteria for Annuities when none is provided for any other investment product line, with only two exceptions – Rule 2860 requiring pre-approval of option accounts and Rule 2865 which includes special criteria for currency and index warrants and securities futures. It is interesting to note that the suitability criteria listed for securities futures appears less onerous than that proposed for Annuities under the Rule.

8. Most Firms have spent considerable resources improving systems for documenting and maintaining suitability information. Suitability is an important part of any investment account and it is not practical to maintain separate, duplicate information for specific Annuity transactions. Modern systems for documenting suitability are tied to the process of opening and maintaining a securities account rather than being tied to specific product lines and/or transactions. Most Representatives work with their clients to build diversified investment portfolios crossing over multiple product lines. It would be an enormous waste of resources and very frustrating for their clients if those Representatives were required to create separate suitability documentation for each type of product included in those portfolios.

9. The Rule would not permit recommendation of an Annuity to a client unless that client has a "long-term investment objective." No clarity is provided as to what "long-term" means; so every firm has to determine the meaning and place themselves in jeopardy if the NASD disagrees. We are aware of no other situation where the NASD has taken a one-dimensional approach to suitability determination. Further, the Rule indicates that each firm is expected to set specific suitability standards such as prohibiting Annuity sales if a client is over a certain age, if the amount being invested exceeds a stated percentage of the customer's net worth or if the amount being invested is in excess of a stated dollar amount. Again, one must assume that the NASD has some age or amounts in their mind, yet they leave Firms to speculate as to what that criteria is. Frankly such measurements may be logical ways to establish screening methods to identify accounts that need a special review, but they do not constitute a practical approach to setting suitability standards. Life is not that simple! Is a 65-year-old client in poor health a good Annuity prospect while an 80-year-old client in good health is not? Two individuals with the same level of assets may be suitable for investing widely disparate amounts in Annuities depending on their cash flow, level of expenditures, risk tolerance, estate planning goals, etc.

While we believe the Rule as proposed should be rejected by the SEC, we also recognize that there have been abuses in the sale and exchanges of Annuities. We have several suggestions that may prove a more effective way to address these issues:

1. The NASD in its arguments supporting the Rule emphasizes that many firms have not followed the "best practices" guidelines previously issued by the NASD, primarily in Notice to Members 99-35. It is this fact that leads the NASD to the conclusion that such "best practices" should be codified in Rules. It is important to note that while the NASD issued certain Investor Alerts and Regulatory Alerts relating to Annuities since 1999, no further comprehensive advisory has been issued updating (or reminding) firms of their obligations in the sale of Annuities for over five years. During that time the there has been significant Annuity product innovation, the sale of

Annuities has grown exponentially, the NASD and other regulators have participated in several "variable sweep exams" and considerable research has been done, resulting in the long-anticipated Joint Report published by the SEC and NASD in mid-2004. It would have seemed reasonable if the NASD had taken this opportunity to update the "best practices" guidelines and re-emphasize the regulatory liability that has resulted where firms failed to adopt reasonable sales practices and supervisory oversight for Annuity transactions. We believe issuance of an "updated 99-35" would encourage member firms, a majority of which are well-intentioned, to voluntarily make further improvements in supervision of variable annuity sales practices. That would be a more reasonable approach than Rule 2821 which, if enacted in its present form, would impose an inflexible and expensive framework that will negatively impact all Firms whether they were responding to regulatory guidance in good faith or not.

2. We concur with the NASD that Firms should provide specialized training for those Representatives involved in the sale of Annuities. It seems to us that this is already required under the Firm Element of the continuing education rules, but we would support the NASD reminding firms of this and suggest that the NASD work with industry members to create appropriate training tools and programs.

3. We believe that any sales practice, suitability and supervisory issues relating to Annuities can be addressed by enforcing existing rules. However, if regulators insist that Annuity transactions must be singled out for special treatment, we believe the model already in existence for Options makes more sense than the special supervision systems that would be imposed by the Rule. A requirement that any investment account has to be pre-approved by a Supervisor before any Annuity transaction can be solicited would require Firms to have a special focus on suitability factors relating to Annuities without massive duplication and elaborate systems changes.

4. We strongly recommend that an Annuity Task Force be established with full participation by both industry and regulators to fully explore sales practice, pricing, suitability, supervision and other regulatory concerns relating to Annuities. As the NASD points out, modern Annuities are complex, hybrid products that combine both investment and insurance attributes. It is our perception that securities regulators are not as knowledgeable about Annuity structure, pricing, distribution, etc. as they are about other investment vehicles. Further, issues relating to Annuities are complicated by a unique blending of state and federal regulatory responsibility and the direct competition between registered and non-registered annuity products. We believe an Annuity Task Force could greatly assist regulators in finding practical solutions to outstanding regulatory issues related to the distribution and sale of Annuities.

In conclusion, we believe the SEC should reject Rule 2821 as presented. We believe that the NASD should be asked to provide to its members an updated sales practice advisory regarding Annuities transactions. Further, we believe that the NASD should continue to aggressively enforce existing NASD Rules on suitability and supervision as they relate to all investment transactions including Annuities. Finally, we strongly suggest that an industry/regulatory task force be formed to address any outstanding regulatory issues relating to Annuities.

Thank you again for the opportunity to comment on these issues.

Sincerely,

John L. Dixon

John L. Dixon
President
Pacific Select Distributors, Inc