



ADVISORS NETWORK

## **By Electronic Mail**

September 19, 2005

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

Re: SR-NASD-2004-183  
Proposed NASD Conduct Rule 2821 on Deferred Variable Annuities

Dear Mr. Katz:

We appreciate the opportunity to comment on NASD's Amendment No. 1 to SR-2004-183 dealing with proposed Conduct Rule 2821 on deferred variable annuities ("Proposal"). ING Advisors Network is the marketing name for a group of retail broker-dealers with a total of over 9,000 representatives.<sup>1</sup> Our representatives are independent contractors and engage in the sales of general securities and packaged products. These comments are submitted on behalf of all of our broker-dealers.

We understand NASD's concerns with sales of variable annuities and the complexity of those products. We agree that professionals selling these products need to be diligent in determining that the products are suitable for investors. We are concerned, however, that the Proposal continues to contain provisions that are unworkable and unclear. NASD has proposed unprecedented supervisory and suitability requirements for these products without first providing any hard data to establish that deferred variable annuities require such unprecedented treatment and without sufficiently addressing the practical implications of its Proposal.

After careful review of the Proposal, we offer the following specific comments.

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<sup>1</sup> The broker-dealers include Financial Network Investment Corporation, Multi-Financial Securities Corporation, ING Financial Partners, Inc., and PrimeVest Financial Services, Inc. and its subsidiary broker-dealers.

## **PRIOR PRINCIPAL REVIEW**

We are very concerned with the Proposal's requirement of principal review and approval of a deferred variable annuity transaction before the application is submitted to the insurance company. We believe this requirement, as currently proposed, is unworkable for introducing independent contractor broker-dealers with Office of Supervisory Jurisdiction (OSJ) structures. As the NASD has noted in the Proposal, NASD Conduct Rule 2820(d) and SEC Rules 15c3-1 and 15c3-3 require, among other things, that a broker-dealer promptly transmit funds received from customers for variable contracts. In general, this has been interpreted to mean by the next business day. For independent contractor introducing broker-dealers with OSJ structures, complying with these rules would be impossible where the check is received from the customer with the application. There would not be sufficient time for representatives to forward the paperwork to the OSJ manager and the OSJ manager to review the application within the time parameters required by the rules.

We note that in the context of contingency offerings under SEC Rule 15c2-4, the SEC provided some relief to the requirements for broker-dealers to promptly transmit customer funds where a broker-dealer's internal supervisory system provided for off-site supervisory review. In this context, the SEC allowed for time for funds to be sent to the reviewing office and then transmitted by that office within one day after receipt by that office.<sup>2</sup> NASD has not sought such relief from the SEC rules in connection with the current Proposal, nor has it offered any relief from its own Rule 2820(d).

The practical result of the Proposal, therefore, would mean that for each sale of a deferred variable annuity, a representative of an introducing broker-dealer would have to have two meetings with the customer. First, to obtain the application and then, after approval of the application, to obtain the customer's payment for the transaction. This would be an extremely burdensome procedure and would result in significant delays in processing customer transactions. This result would be of questionable benefit to the investing public and NASD has offered little support for its proposition in view of these issues. Further, such a requirement would have substantial anti-competitive effects for broker-dealers who are not permitted to hold customer funds and securities pursuant to their particular status under SEC Rule 15c3-1 and membership agreements with the NASD.

The only other practical alternative available to introducing broker-dealers would be to require that review of all deferred variable annuities be done at a central location in order to minimize the potential impact of SEC Rules 15c3-1 and 15c3-3 and NASD Conduct Rule 2820(d). This would, of course, require that firms establish procedures requiring that variable annuity applications and checks be sent by overnight mail to the central location and then reviewed on the day of receipt. This would represent an unwarranted disturbance of many firms' supervisory structures. Firms with OSJ

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<sup>2</sup> See, Letter to Linda A. Wertheimer, dated October 16, 1984 and NASD Notice to Members 84-64.

structures would be forced to bifurcate the supervisory review of securities transactions into review of deferred variable annuities by one supervisor who is remote from the day-to-day business of representatives and other securities by another supervisor who is more familiar with the representatives' overall businesses. In addition to the substantial costs this bifurcation would impose on broker-dealers, the resulting limited time for any real supervisory review and the disjointed supervision of all of the broker-dealers securities business would not be in the public interest.

## **SUPERVISORY PROCEDURES AND PRINCIPAL REVIEW REQUIREMENTS**

We continue to have concerns about the NASD's proposed suitability standards for review of deferred variable annuity transactions. It continues to be unclear why the general suitability standards of Conduct Rule 2310 are not sufficient to cover variable annuity transactions.<sup>3</sup> If the NASD believes that current suitability guidelines are not sufficient, it should set forth more specific standards than those currently suggested.

In particular, we note the NASD's proposal that supervisory procedures and principal review requirements include review of such things as a customer's specific age, short-term investment objective, and percentage of net worth for the transaction with each to have a "standard to be established by the member." We believe that the requirement for broker-dealers to use specific numbers in their supervisory procedures, without guidance from the NASD as to what those number should be, will subject broker-dealers to inconsistent regulation by the various NASD offices. Members could be cited for insufficient procedures merely because a particular NASD examiner does not agree with the numbers stated, while another district office staff takes a different position. We have encountered this problem with other rules adopted in the last few years. We expect that NASD will have to develop internal guidelines for their examining staff and those guidelines should be shared with the membership in advance of the Proposal's effective date.

### **Comparison with Other Products**

We have significant concerns with the proposed requirement that a representative and broker-dealer have a reasonable basis to believe that a customer has a "need" for the features of a deferred variable annuity as "compared with other investment vehicles." Such a requirement for suitability determination is unprecedented. We know of no other Conduct Rule that requires a broker-dealer to determine that a security is "needed" by a customer or that requires a comparison with other investment vehicles, nor is it clear how such a mandate could be carried out.

Securities transactions may be entirely suitable for a customer in view of the customer's entire financial situation without regard to whether a customer "needs" the product.

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<sup>3</sup> We note the NASD's statement that sales of variable annuities will continue to be covered by Rule 2310, regardless of the use of proceeds. It is not clear why a suitability rule relating to variable annuities should not address both the purchase and sale of the product in a single rule.

Arguably, no customer “needs” a specific security. A customer may, however, benefit from one or more of the features of a deferred annuity. It is not clear how a broker-dealer could determine that the benefit is “needed” by the customer. Such a new standard of suitability, without clear guidance and definition is unworkable.

Further, the requirement that a variable annuity be compared with other investment products seems to conflict with NASD’s longstanding concerns about product comparisons. Additionally, the Proposal is silent as to what such a comparison must entail or with which other investment vehicles a deferred variable annuity must be compared. Deferred variable annuities offer unique features that are not available in other products. They are simply not comparable with other products.

### **Long-Term Investment Objective**

The Proposal requires that a customer must have a “long-term” investment objective in order to purchase a deferred variable annuity. While we agree that an investor’s time horizon is an important consideration in determining suitability, we do not agree that the time horizon must be “long-term” in all circumstances. This requirement is both nebulous and inappropriate. As previously noted, before imposing such a standard, NASD should specifically and unambiguously define what it means by “long-term.” Further, because of the various features of variable annuities, such as death benefits, waiver of surrender charges, and certain estate planning advantages, among others, a deferred variable annuity may, in fact, be entirely suitable for a given customer without regard to the customer’s age and potential for a “long-term” investment. Categorically denying access to these products for customers over a certain age will not be in the public interest.

### **DISCLOSURE OF MATERIAL FEATURES OF DEFERRED VARIABLE ANNUITIES**

In its original proposal, NASD would have required broker-dealers to provide customers with a plain English risk disclosure document highlighting the main features of a proposed variable annuity. As we previously commented, this proposal had substantial potential negative consequences under federal securities laws and state insurance laws, as well as contractual and other practical difficulties.<sup>4</sup> The NASD now proposes that an associated person document and sign a statement that the customer “has been informed of the material features of the deferred variable annuity.” It is unclear how this differs materially from NASD’s original proposal. What degree of specificity must the document include beyond providing the customer with a copy of the prospectus? What does NASD deem to be the “material features” of the variable annuity?<sup>5</sup> How detailed must the signed statement be?

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<sup>4</sup> Please see our comment letter to Notice to Members 04-45, dated August 9, 2004, a copy of which was filed by the NASD as Exhibit 2c to its original rule filing.

<sup>5</sup> We note footnote 15 to the Proposal in which NASD identifies certain features that an associated person should “highlight” “at a minimum.” These suggestions are not part of the rule itself and are obviously not meant to be all-inclusive, and are therefore not helpful in deciding how the rule should be construed or in

We believe that the issues we previously raised continue to apply to this Proposal and NASD needs to provide far more clarity as to what is expected before any such rule is adopted. We continue to urge NASD and the SEC to work together to provide better product clarity to investors through means other than rules that could expose broker-dealers to unwarranted risks. In particular, we believe that any simplified disclosure documents should be part of a prospectus and not a document created individually by the thousands of broker-dealers who distribute products.

We note NASD's statement in the Proposal that it will continue to separately consider whether to propose specific point-of-sale disclosures. We urge NASD to continue its study before imposing a similar, but more vague requirement as set forth in the Proposal.

## **TRAINING**

We agree that registered representatives who sell variable annuities and principals who review transactions should understand the product. We do, however, question the need for a specific training requirement for this product that goes above and beyond training requirements for other products. The NASD qualification examinations already include variable products and various state insurance laws require training in insurance products that go beyond the NASD examinations. Broker-dealers have continuing education requirements. The rule is unclear as to what additional training is contemplated, at what point in time the training must occur, and what ongoing obligations there are, if any, to provide additional training.

We believe that if training on a specific product that goes beyond training on firm-specific procedures is deemed necessary, the NASD should develop standardized training for the industry. Otherwise, the industry will be left in the same predicament as noted above of potential inconsistent regulation. If NASD determines not to proceed with standardized training, NASD should consider that no training can "ensure" that associated persons will "understand the material features" of a variable annuity. Further, the language of the proposed rule, at a minimum, should be changed to simply set forth the required subject matter of the training. Further, no training can "ensure" that associated persons will comply with the proposed rule. Rather, the reasonableness standard that applicable to supervision in general should be adopted.

## **TIMING OF RULE IMPLEMENTATION**

The NASD proposes that the rule should go into effect 120 days after approval by the SEC. We believe that such a time frame is unreasonably short given the changes that will be required in broker-dealer supervisory systems. We suggest that a time frame of at least 180 days would be more appropriate.

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understanding how it will be enforced. Additionally, we are concerned with any concept that an associated person should "highlight" portions of a prospectus.

## **CONCLUSION**

Again, we appreciate the opportunity to comment on the Proposal. Should you have any questions, please contact us.

Respectfully submitted

John S. Simmers  
CEO