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ProEquities

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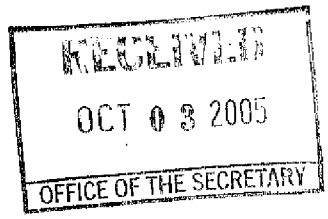

Jonathan G. Katz, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: File No. SR-NASD-2004-183 - 122
Release No. 34-52046A; Proposed NASD Rule 2821 -- Members' Responsibilities Regarding Deferred Variable Annuities

Dear Mr. Katz:

ProEquities, Inc. ("ProEquities" or "the Firm"), a registered broker/dealer firm, wishes to submit these comments on proposed NASD Rule 2821, which addresses deferred variable annuity sales practices (the "Proposed Rule").

I. Overview

ProEquities strongly supports the elimination of the requirement to deliver to the customer, before any purchase, sale or exchange of a deferred variable annuity, the "risk disclosure document" referred to paragraph (b)(1)(B) in the original deferred variable annuity rule proposal (the "Original Proposal") set forth in NASD Notice to Members 04-45. As the Firm noted in its August 6, 2004 comment letter on the Original Proposal (the "Original Comment Letter"), the Firm believes that the suggested disclosure document would have exaggerated the importance of a relatively small number of variable annuity features, leading to unbalanced disclosure that was unlikely to improve the customer's overall understanding of the proposed transaction.

As discussed in more detail in the Original Comment Letter, ProEquities believes that (a) the customer should be able to rely on the prospectus as his or her best, most balanced source of information about a variable annuity product, and (b) the issuing insurance company is in the best position to produce a disclosure document that accurately portrays the material features of the contract. For these reasons, and to streamline the disclosure process to the benefit of all concerned (including the investing public), the Firm recommends that the SEC develop "plain English" prospectuses for

variable annuities. As part of this process, the SEC could seek public input on ways to improve prospectus disclosure. In this way, the party that is the most familiar with the product will prepare the most important disclosures, using uniform standards developed after public comment.

Similarly, ProEquities strongly supports the elimination of the requirement to deliver to the customer, before the exchange or replacement of a deferred variable annuity, the exchange or replacement disclosure document referred to paragraph (b)(2) in the Original Proposal. As discussed in more detail in the Original Comment Letter, the Firm believes that this requirement would have made exchange transactions more expensive and more confusing for the customer, without improving the quality of the disclosure in any meaningful way.

Finally, the Firm strongly supports the elimination of the requirement that a registered principal review and approve a deferred variable annuity transaction within one business day after execution of the application (as provided in paragraph (c) of the Original Proposal), and the adoption of the proposed requirement that the review and approval occur before the application is sent to the issuing insurance company for processing. As discussed in more detail in the Original Comment Letter, imposing a one-day time limit on principal review is unnecessary, and would result in either (1) reviews that are conducted in a hurried manner, or (2) legitimate trades that are initially rejected because the registered principal is unable to complete an adequate review before the one-day period is over.

ProEquities believes that these changes, and many others that are reflected in the Proposed Rule, have resulted in a Proposed Rule that is a significant improvement over the Original Proposal. The Firm's remaining comments and concerns regarding the Proposed Rule are discussed below.

II. Treatment of Subsequent Investments

Proposed Rule 2821(a)(1) provides that the Rule would apply to "any purchase or exchange of a deferred variable annuity" (and to initial subaccount allocations). The Firm agrees that the Proposed Rule should not apply to a customer's sale of a deferred variable annuity, or to reallocations of subaccounts.

As written, the Proposed Rule does not appear to apply to investments made in a deferred variable annuity after the initial purchase. (For example, in addition to the language quoted above, Proposed Rule 2821(c) contemplates principal review only before the initial application is sent to the issuing insurance company.) Subsequent purchases are often small amounts, and may be made as part of a regular investment program. In addition, many customers make additional investments by sending funds directly to the insurance company on an "application way" basis, without consulting with the member firm or its registered representatives. The Firm believes that the Proposed Rule should only apply to the initial purchase of a deferred variable annuity (and not to

subsequent investments), and that the final rule (or language in the adopting release) should clarify this point.

III. Investment Objectives.

Proposed Rule 2821(b)(1) provides that a member or an associated person ***may not recommend*** "the purchase or exchange of a deferred variable annuity unless the member or person...has a reasonable basis to believe that ...(B) the customer has a long-term investment objective." This amounts to a regulatory determination that a deferred variable annuity can be appropriate ***only*** if the customer has a "long-term" investment objective. This requirement is vague, it is wrong, and it is contrary to the American principle of allowing customers to make informed investment decisions after consultation with their investment professionals.

ProEquities agrees, of course, that deferred variable annuities, as currently structured, are generally more suitable when the customer has a "long-term" investment objective. As discussed in more detail below, the Firm does not object to a rule that would require special scrutiny of a deferred variable annuity purchase when information provided by the customer indicates that the customer does not have a long-term investment objective. However, special contract features, or the expressed desires of the customer, may make deferred variable annuities suitable for other investors as well, and NASD rules should not prohibit a member and its associated persons from making an appropriate recommendation when this is the case.

If the NASD and SEC remain convinced that they should make this decision for American investors, they should at least define "long-term". Is it five years, ten years, twenty years, thirty years, or some other length of time? Since the NASD and SEC apparently have some standard in mind, they should tell members, associated persons, and investors what that standard is; otherwise, members and their associated persons will be subject to the hindsight of the NASD, disgruntled customers, and their counsel, if the member selects an investment horizon that a regulator or arbitrator later determines was inappropriate. Furthermore, different individuals within the NASD, and different NASD districts, may have different views about the appropriate standard. This type of *de facto* rulemaking is unfair, inefficient and expensive. Also, many customers have multiple investment horizons, and purchase different investments to meet different needs. The NASD and SEC should not prohibit such an investor from buying a deferred variable annuity with a portion of his or her assets, even if the investor chooses to invest the remainder in speculative or short term investments.

Proposed Rule 2821(b)(1) provides that a customer must have a long-term investment objective for an exchange of a deferred variable annuity. Such a requirement is clearly inappropriate, since it would prohibit a member or its associated persons from recommending (for example) that an older customer with a "short" overall investment horizon exchange a more expensive deferred variable annuity (or one with fewer benefits) for a less expensive one (or one with more benefits).

IV. Use of the Deferred Variable Annuity

Proposed Rule 2821(b)(2) would require the member or an associated person to make a reasonable effort to obtain, among other things, the "intended use of the deferred variable annuity." This phrase is vague and would confuse members, associated persons and investors. Deferred variable annuities are investment contracts with insurance features, and can be "used" for almost any purpose (other than, perhaps, as a reserve for short-term or emergency funds). Are such "uses" as "retirement savings", "long term savings", "estate planning", "tax deferral", "principal preservation with upside potential", "minimum monthly benefits" or "potential annuity stream" adequate, or does the Proposed Rule contemplate some type of narrative disclosure? The Firm believes that this requirement should be deleted; if it is retained, the SEC needs to provide guidance on the types of "uses" that it believes are appropriate.

V. Principal Review—"Need for the Features" and "Need for any Potential Product Enhancements and Improvements"

Proposed Rule 2821(c)(1)(A) provides that when reviewing a purchase or exchange of a deferred variable annuity, the registered principal shall consider whether "the customer ***appears to have a need*** for the features of a deferred variable annuity as compared with other investment vehicles" (emphasis supplied). Similarly, Proposed Rule 2821(c)(1)(D) provides that when reviewing an exchange of a deferred variable annuity, the registered principal shall consider whether "the customer ***appears to have a need*** for any potential product enhancements and improvements" (emphasis supplied). These standards should be deleted, since they are hopelessly vague, and would require the registered principal to read the customer's mind in order to review a proposed transaction.

All deferred variable annuities have at least two features—tax deferral and the ability to purchase an annuitized income stream—which every customer would like, and which most customers "need" to some extent. Other common deferred variable annuity features, such as principal guarantees, benefit guarantees, and bonus premiums, will also be considered "helpful" by some customers and "essential" by others. For exchanges, it is hard to argue that a customer would not "need" lower fees, but whether a customer would "need" different investment choices or a minimum guarantee income stream (for example) is more subjective. To say it differently, the "need" for any investment feature is inherently subjective, and depends as much on the investor's emotional state of mind as it does on the investor's financial situation. The associated person who is assisting the customer can be expected to understand the customer's views on these matters; the same thing cannot be said of the registered principal who is reviewing the transaction. For example: (a) a customer in the lowest tax bracket may want tax deferral, because he or she simply hates paying taxes, (b) a wealthy individual may want a principal guarantee feature, even though the individual's financial information indicates that he or she could "afford" to lose the entire amount being invested, and (c) a customer might want a bonus premium, even though the associated deferred variable annuity has higher annual expenses. In each of these situations, purchase of a deferred variable annuity by an

informed customer would appear to be appropriate, even though the trade documentation would be unlikely to reflect how the customer's "needs" were being satisfied.

VI. Principal Review of Specific Criteria

Proposed Rule 2821(c) (and the related supervisory procedures set forth in Proposed Rule 2821(d)) would require the registered principal who is reviewing the purchase or exchange of a deferred variable annuity to consider, among other things, the customer's age, whether the customer has a short term investment objective, the amount of money the customer is investing in the deferred variable annuity (expressed as a percentage of the customer's net worth), and the amount of money the customer is investing in the deferred variable annuity (expressed as an absolute dollar amount). (The Firm notes that net worth is not one of the items of information listed in Proposed Rule 2821(b)(2), although liquid net worth is listed.) Each such standard is to be established by the member.

If this rule is adopted, it is inevitable that different members will establish different standards. For example, different members might use ages 60, 62, 65, 70, 75 or 80 for the age standard, and 10%, 20%, 25%, 30% or 40% for the percentage of net worth standard. As discussed under Item III above, the member would be subject to the hindsight of the NASD, disgruntled customers, and their counsel, if the member selects criteria that a regulator or arbitrator later determines were inappropriate.

There is no reason to believe that the sale of a deferred variable annuity to a customer of a given age (for example) at one member firm is less likely (or more likely) to be suitable than the sale of a deferred variable annuity to a customer of the same age at a different member. If the SEC and the NASD believe that, in general, deferred variable annuity sales to customers who exceed a certain age (or meet the other criteria listed above) should be subject to special scrutiny, then they should announce what those standards are. Member firms could then apply uniform standards to these trade review practices.

ProEquities strongly encourages the SEC to make it clear that the standards referred to above merely indicate that a transaction may require special scrutiny. The final rule should explicitly state that these standards are not a "bright line" test, and the fact that a transaction falls into one or more of the categories noted above does not automatically mean that it is not suitable. Of course, these standards would not need to be safe harbors, either—the member firm would always bear the responsibility for recommending suitable trades, taking into account all of the information known about the customer (not just one or two special items, as suggested by the Proposed Rule's emphasis on age and other enumerated factors).

VII. Principal Review of Non-Recommended Trades

Proposed Rule 2821(c)(1) would require a registered principal to make a suitability determination with respect to a customer's purchase or exchange of a deferred

variable annuity, even if the proposed trade had not been recommended by the member. The proposed principal review requirement for trades that were not recommended by the member firm would impose a new, unwarranted suitability determination on members and their registered principals, and would be impracticable to implement. Proposed Rules 2821(b)(1) and (c)(2) provide, collectively, that if the member or an associated person has recommended a purchase or exchange, the associated person will produce and sign a suitability determination document that a registered principal can review. If the member or associated person did not recommend the purchase or exchange, this suitability determination document is not (and should not be) required. Without such a document, or other similar documentation provided by the customer, conduct of a meaningful registered principal review will be difficult or impossible.

Furthermore, current NASD Conduct Rule 2310(a) generally requires the member to make a suitability determination only if the member recommended the trade. The NASD and SEC should not impose a new, burdensome suitability determination on non-recommended transactions, as set forth in the Proposed Rule. If the NASD and SEC believe that this course of action is appropriate, we recommend that the NASD and SEC revisit the suitability requirements of Rule 2310(a) in a broad-based rulemaking, and not impose additional standards for suitability review on a single product.

VIII. Principal Review—Previous Exchanges

Proposed Rule 2821(c) (and the related supervisory procedures set forth in Proposed Rule 2821(d)) would require the registered principal who is reviewing the exchange of a deferred variable annuity to consider, among other things, whether "the customer's account has had another deferred variable annuity exchange within the preceding 36 months." In addition, the supervisory procedures set forth in Proposed Rule 2821(d) (but not the provisions of Proposed Rule 2821(c)) would require a registered principal who is reviewing the exchange of a deferred variable annuity to consider, among other things, whether "the associated person effecting the exchange has a particularly high rate of effecting deferred variable annuity exchanges." (The Firm believes that the word after "person" should be "affecting".) Both of these standards are vague and are of questionable value in assessing the suitability of a particular transaction.

The Firm believes that it is unnecessary and impractical to review the rate of exchanges by a particular customer, or in an associated person's customer base, every time a customer submits an exchange transaction. This type of exception report is more appropriately used on a periodic basis (for example, once a quarter) to determine whether there are any trends in an associated person's business practices that need to be reviewed. Of course, if the reports do create a "red flag", special supervision of the associated person's business may be in order. As a general matter, however, the Firm believes that running such a report after each exchange transaction is submitted is not a cost-effective method to review these transactions, and would not significantly improve the supervision thereof.

If these requirements are retained, the Proposed Rule needs to be clarified. With respect to the first standard, does the customer's "account" refer to the customer's history with the member, or does it include transactions that occurred at another member firm? Does it refer to only the deferred variable annuity being exchanged, or to other deferred variable annuities (or variable universal life insurance policies) that the customer may own? Does it include other accounts to which the customer is a party, such as joint accounts, custodial accounts, or IRA accounts?

With respect to the second standard, what does "rate of...exchanges" mean? Does it refer to a percentage of the associated person's total deferred variable annuity transactions? Does it refer to a percentage of the associated person's customer base, or to a percentage of assets invested in variable annuities? Over what period is the "rate" to be measured? Does it matter if the previous transactions were clearly appropriate, under the highest standard of review? Finally, what is a "particularly high rate" of exchanges? As with the criteria discussed at Item VI above, there is no reason to believe that a given rate of exchanges at one member firm is less likely (or more likely) to be appropriate than the same rate of exchanges at a different member. If the SEC and the NASD believe that, in general, a given rate of exchanges should be subject to special scrutiny, then they should clearly defined the standards and announce what those standards are. Member firms could then apply uniform standards to these trade review practices.

IX. Training

The Firm supports adoption of the training requirements set forth in Proposed Rule 2311(e).

X. Conclusion

ProEquities appreciates this opportunity to comment on the Proposed Rule. If you wish to discuss the Proposed Rule, this letter, or any thoughts, comments, questions or suggestions that you may have, please call me at (205)268-5144.

Very truly yours,

PROEQUITIES, INC.

By: _____
Michael J. Mungenast
President

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