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July 19, 2006

VIA E-MAIL

Ms. Nancy M. Morris
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: File Number SR-NASD-2004-183; Release No. 34-54023 Amendment No. 2 to Proposed Rule Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities

Dear Ms. Morris:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee").[1] The letter responds to a request for comments by the Securities and Exchange Commission (the "SEC" or "Commission") on Amendment Number 2 to proposed Conduct Rule 2821 ("Rule 2821" or the "Proposed Rule") of the National Association of Securities Dealers, Inc. ("NASD"). The Proposed Rule would create recommendation requirements (including a suitability obligation), principal review and approval requirements, and supervisory and training requirements that would apply solely to purchases and exchanges of deferred variable annuity contracts ("VAs").[2]

As described in more detail below, the Committee recognizes that NASD has made significant revisions to the Proposed Rule. However, the Committee believes there are a number of areas where Rule 2821 remains burdensome, unclear, and even unworkable, without providing any additional benefit to the customer. The remainder of this comment letter provides: a review of the administrative history of the Proposed Rule; recognition from the Committee of certain appropriate revisions to the Proposed Rule; and specific comments from the Committee on the Proposed Rule. In particular, the Committee provides comments below on:

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[1] The Committee of Annuity Insurers is a coalition of 29 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over half of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

[2] *See Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing Amendment No. 2 to Proposed Rule Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities,* Securities Exchange Act Release No. 54023; File No. SR-NASD-2004-183 (June 21, 2005), 71 Fed. Reg. 36,840 (June 28, 2006).

1. the principal approval requirements, including the two business day review deadline;
2. Rule 2821(b)(1)(B) requiring a finding that the customer would benefit from the "unique" features of VAs;
3. the "undue concentration" standard articulated for the first time in the principal review section at Rule 2821(c)(1)(C);
4. the proposed supervisory procedures to screen each transaction based on associated person exchange rates at Rule 2821(d); and
5. certain other issues.

I. Administrative History of Rule 2821

NASD initially proposed Rule 2821 in June 2004.[3] As proposed, the rule would have imposed a series of new requirements on NASD member firms and their associated persons selling variable annuities. After NASD proposed Rule 2821, it received over 1,100 comment letters, including one from the Committee. Commenters overwhelmingly opposed certain provisions of the rule as unworkable and unnecessary. NASD significantly revised the rule, scaling it back in several respects.[4] Then, in December of 2004, NASD filed the revised rule with the SEC for publication for public comment as required by Section 19(b) of the Securities Exchange Act of 1934 (the "1934 Act") and Rule 19b-4 thereunder.

Although NASD filed Rule 2821 with the SEC in December 2004, the SEC did not publish that version of the Proposed Rule for public comment. On July 8, 2005, the NASD filed an amended rule proposal reflecting yet additional revisions to the rule ("Amendment No. 1 to the Proposed Rule").[5] On July 21, 2005, the SEC published Amendment No. 1 to the Proposed Rule in the Federal Register for public comment.[6] The Committee submitted a comment letter on September 19, 2005 ("2005 Comment Letter"),[7] and was joined by more than 1,500 other commenters on Amendment No. 1 to the Proposed Rule. NASD filed Amendment Number 2 to the Proposed Rule with the

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[3] The rule was published for comment by NASD in Notice to Members 04-45 (June 2004).

[4] NASD eliminated prospectus delivery, risk disclosure document, and mandatory exchange form requirements from the Proposed Rule at that time.

[5] The text of Amendment No. 1 to the Proposed Rule can be found at: http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_014678.pdf.

[6] The notice of filing Amendment No. 1 to the Proposed Rule can be found at: http://a257.g.akamaitech.net/7/257/2422/01jan20051800/edocket.access.gpo.gov/2005/pdf/E5-3903.pdf.

[7] The 2005 Comment Letter can be found at: http://www.sec.gov/rules/sro/nasd/nasd2004183/wtcomer091905.pdf

SEC under Rule 19b-4 of the 1934 Act on May 4, 2006.[8] The SEC posted the rule filing on its website on June 21, 2006, and published the Proposed Rule for comment in the Federal Register on June 28, 2006.[9]

II. Revisions to the Proposed Rule

The Committee recognizes NASD considered, and in some cases responded to, comments submitted in response to Amendment No. 1 to the Proposed Rule, contributing in certain respects to the fairness and functionality of the Proposed Rule as revised in Amendment Number 2. In particular, the Committee believes the following changes will make the Proposed Rule more workable: elimination of the "need for" and "comparability" requirements as proposed in Amendment No. 1 to the Proposed Rule;[10] clarification that Rule 2821 is inapplicable to subsequent purchase payments;[11] and elimination of the "bright line" test requiring the finding of a long-term investment objective and net worth and purchase dollar amount requirements.[12]

III. Committee Comments on the Proposed Rule

As noted above, the Committee remains very concerned with several aspects of the Proposed Rule. The Committee strongly recommends that serious consideration be given to reviewing and re-formulating the provisions of the Proposed Rule addressed below.

A. The Principal Review Process – Rule 2821(c)

The Committee continues to believe that the proposed timing requirements relating to principal review of VA transactions are unworkable in some situations, and urges the NASD to adopt a "prompt" standard. Such a standard will achieve the Proposed Rule's customer protection goals, while preserving the ability of the broker-dealer to focus on the quality, rather than the speed, of their review. The Committee also has significant concerns regarding certain statements made by NASD relating to the use of electronic systems to facilitate such review, and the principal review of exchange transactions.

Timing of Principal Review. The Proposed Rule would require that a registered principal review and determine whether he or she approves a transaction no later than two business days following the date when the customer's application is transmitted to the

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[8] The NASD's rule filing with the SEC can be found at:
http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_016480.pdf
[9] The notice published in the Federal Register can be found at:
http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_016897.pdf
[10] 71 Fed. Reg. at 36,844. *See also* 2005 Comment Letter at p. 5-6.
[11] 71 Fed. Reg. at 36,842. *See also* 2005 Comment Letter at p. 13.
[12] 71 Fed. Reg. at 36,845. *See also* 2005 Comment Letter at p. 4-5.

issuing insurance company for processing.[13] The NASD clarified that the principal's review would need to be *completed*, not simply underway, within two business days.[14]

Responding to the significant level of comment on the timing of principal review received in response to Amendment No. 1 to the Proposed Rule,[15] the SEC requested specific comments about the timing requirements. The Commission asks how, if at all, the Proposed Rule's principal review timing requirements would impact a firm's ability to efficiently review VA transactions. It further asks for comment about any changes that member firms would need to make to their supervisory procedures and systems in order to comply with the Proposed Rule's timing requirements and whether such procedures and systems could be made to accommodate the new requirements.

The Committee believes that the proposed timing requirement for principal review is counter-productive and in some situations would not provide enough time for thorough principal reviews. This could lead to a mechanical, "checklist" approach rather than a thoughtful, substantive and complete review. Customer interests and regulatory objectives are better served by subjecting the timing of principal approval to a "prompt" standard. This standard could provide flexibility to the principal review process on a transaction-by-transaction basis that maximizes the opportunity for the protection of investors.

The suitability review process for the purchase of a deferred variable annuity is multi-faceted. The variable annuity contract as a whole and the customer's allocation into the contract's underlying funds need to be reviewed, as does selection of certain of the contract's optional guarantees such as living benefits. As part of their comprehensive review, principals may need to seek additional information or confirmation of certain facts from the registered representative who sold the annuity or directly from the customer. While many firms view such outreach calls as a critical component of their suitability review process, the Proposed Rule's timing requirements would serve to discourage such outreach. A principal seeking additional information could in fact be hesitant to conduct outreach because of a concern that his or her call to a customer would not be returned within the two-day required time frame.

As noted, we believe that the Proposed Rule should be revised to require that principal review be subject to a prompt standard. This will ensure that a firms' review process is robust while not discouraging a principal from undertaking additional inquiry. It appears that NASD proposed the two day review requirement primarily to ensure that a VA contract is not issued prior to the completion of the principal review. However, the Committee notes that, even with the two-day standard, contracts may be issued prior to completion of the suitability review. Commenters have already soundly criticized as

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[13] Rule 2821(c)(1).
[14] 71 Fed. Reg. at 36,845.
[15] The publication in the Federal Register describes "numerous" commenters objecting to the principal review deadline under Amendment No. 1 to the Proposed Rule. 71 Fed. Reg. at 36,844.

unworkable an express pre-approval requirement (i.e., requiring that the principal review occur prior to transmission of the application). In any event, the Committee's fundamental belief is that it is more important to allow sufficient time for a thorough review, and if suitability issues are identified, firms can, as is currently the case, address these issues either through unwinding or modifying the transaction. Customer interests are best served by keeping the requirements surrounding the transaction review and contract issuance processes separate, thus ensuring that the transaction review process is robust and the contract issuance process is able to adapt to technological innovation.

Use of Automated Systems to Facilitate the Suitability Review. The NASD rule filing notes that a firm may use an automated supervisory system or a mix of automated and manual supervisory systems to facilitate compliance with the rule. The NASD further notes that if a firm intends to rely on an automated system to comply with a proposed rule, a registered principal must: (1) approve the criteria that the automated system uses; (2) audit and update the system as necessary to ensure compliance with the proposed rule; (3) review exception reports that the system creates; and (4) remain responsible for each transaction's compliance with the proposed rule.[16] Moreover, the NASD notes that a principal would be responsible for any deficiency in the system's criteria that would result in the system not being reasonably designed to comply with the rule.

The Committee is concerned about the process NASD employed for announcing, and the content of, the automated review standards. The standards were announced in Amendment No. 2 to the Proposed Rule and were not previously addressed in any of the materials relating to the Proposed Rule. The Committee believes that if NASD wishes to impose standards on automated suitability review practices, it should do so for all securities products, not just for VAs. Moreover, the automated review standards should be a part of Rule 2310 (or an "Interpretive Material" to Rule 2310), rather than imposed through the releases accompanying a rule filing with respect to one particular type of security product.

In addition, the Committee has conceptual concerns with the NASD creating a separate standard for automated review systems as opposed to manual review systems. Any system used by a firm is properly subject to the general standards set forth in NASD Conduct Rule 3010 and subject to the requirements of Rules 3012 and 3013.

Finally, the Committee is uncertain as to how to read the responsibilities under the proposed automated review standards in broker-dealer distribution structures with multiple principals reviewing transactions. The standards should be revised to clarify that more than one registered principal may be responsible for suitability review, and the firm should be free to allocate supervisory responsibilities among its qualified, registered

[16] *See* 71 Fed. Reg. at 36,845.

principals as it deems appropriate, rather than a single registered principal being solely responsible.

Principal Review of Exchange Transactions. Proposed Rule 2821(c)(1)(D)(iii) requires that, in connection with an exchange of a VA, the registered principal must consider the "extent to which . . . the customer's account has had another deferred variable annuity exchange within the preceding 36 months." The Committee believes this provision is unclear as to whether the reviewing firm has an obligation to collect information on the customer's exchange activity only with such reviewing firm, or any account of the customer with *any other* firm, over the previous 36 months. If the Proposed Rule is referring to *any* customer account, there should be guidance as to what level of inquiry is expected into such customer's exchange activity with other firms, and how that inquiry should be documented. For example, what if the customer refuses to provide information on their previous exchange activity?

B. Proposed Rule 2821(b)(1)(B)

As described above, the Committee believes that Proposed Rule 2821(b)(1)(B) makes Rule 2821 more workable by removing the focus on whether a purchaser "needs" a VA, and on the comparison of a VA to other investment products. The Committee believes those provisions included in Amendment No. 1 to the Proposed Rule were unworkable, unfair and did not provide meaningful additional customer protections to purchasers of VAs. The Proposed Rule now requires that a member firm can make a recommendation of a VA only if there is a reasonable basis to believe that:

> the customer would benefit from the unique features of a deferred variable annuity (e.g., tax-deferred growth, annuitization, or a death benefit).

The Committee has several suggestions for this requirement. First, the Committee believes that the word "unique" should be eliminated. The insertion of "unique" adds little substance or clarity to the requirement and may serve to confuse member firms and their associated persons. In addition, tax-deferred growth is not a feature present only through VAs, but rather can be found in accounts and retirement plans such as individual retirement accounts and 401(k) plans. In addition, the death benefit feature is not unique to VAs either, as it appears in other insurance policies and security products (variable life insurance). Therefore, the Committee believes that the word "unique" should be removed from Proposed Rule 2821(b)(1)(B).[17]

The Committee also believes that the non-exclusive list of features identified in the Proposed Rule should be expanded to cover certain common VA features that offer

[17] The Committee recommends conforming changes to the principal review provisions under Rule 2821(c)(1)(A).

significant value to VA purchasers. For example, the Committee believes that specific references to certain living benefits should be referenced as part of the list of features from which a purchaser might benefit. Many VAs include living benefits such as guaranteed minimum withdrawal benefits and/or guaranteed minimum income benefits that can be a significant benefit to the VA purchaser.

C. "Undue Concentration" under Rule 2821(c)(1)

In Rule 2821(c)(1)(C), NASD has deleted the requirement that the principal review should focus on VA purchases that exceed certain dollar amount or net worth thresholds, and has replaced it with a requirement to consider "the extent to which the amount of money invested would result in an undue concentration in a deferred variable annuity or deferred variable annuities in the context of the customer's overall investment portfolio." While the Committee views the departure from a rule that would have required member firms to impose a rigid dollar amount test in their principal review as an improvement,[18] the Committee believes that requiring the principal to consider whether there is an "undue concentration" of assets invested in VAs is duplicative of the requirements under Rule 2821(c)(1)(B) to review the customer's liquidity and other needs. The Committee presumes that the requirement for a firm's registered principal to review whether there is an "undue concentration" in VAs for a particular customer would necessarily entail a review of the customer's liquidity needs. For example, if the customer has significant expenses on a monthly basis, and scarce liquid investments, then the member firm may determine that the assets invested in a VA may result in an "undue concentration" of assets in the VA versus the overall investment portfolio. The Committee also notes, and objects to the fact, that no other security products are subject to an "undue concentration" test.

Because of the redundancy with Rule 2821(c)(1)(B), the Committee believes Rule 2821(c)(1)(C) should be deleted. If the undue concentration test focuses on something other than liquidity, or is a more stringent standard than the liquidity standard under Rule 2821(c)(1)(B), the Committee respectfully requests additional guidance as to what the other factors may be and how this aspect of principal review differs from the liquidity review already required.

D. Supervisory Procedures on Exchanges

Rule 2821(d) requires that a firm's supervisory procedures must screen transactions for "whether the associated person effecting the transaction has a particularly high rate of effecting deferred variable annuity exchanges." As a practical matter, this would appear to require that the member firm establish procedures to ensure that each

[18] The Committee believes that such dollar amount reviews are better used as one way in which a firm may monitor its VA business through exception reports, as suggested in the Joint SEC/NASD Report: On Examination Findings Regarding Broker-Dealer Sales of Variable Insurance Products (June 2004) ("Joint Report").

associated person recommending a VA transaction ("registered rep") be tracked mathematically with respect to their exchange activity, and that, with respect to certain registered reps (e.g., those that exceed a certain firm-designated percentage that would be deemed to be "particularly high"), any VA exchanges should be subject to some sort of unarticulated consequences or different review process than exchanges recommended by other registered reps. NASD has not suggested what the consequences should be if a registered rep with a "particularly high" rate submits exchange business. Should the business be automatically rejected? Does the business need to be subject to heightened review, or review by more than one principal? Should additional disclosures be provided to the customer or customer outreach be conducted with respect to the proposed transaction when a registered rep with a "particularly high" rate of exchanges recommended the transaction?

The Committee believes that the provisions related to exchanges in Rule 2821(c)(1)(D), which are incorporated in the provisions related to supervisory procedures in Rule 2821(d), carefully set forth the criteria that should be used to review and approve a VA exchange transaction. In addition, the Committee strongly believes that creating an overlay of review on a registered rep-by-registered rep basis for every VA transaction where a registered rep has been deemed to have a "particularly high" rate of exchanges is difficult to implement, creates little additional customer protection, and should be deleted. The Committee believes that these issues are much better suited to being addressed through exception reporting on a periodic basis, and developing appropriate remedial standards for registered reps on a case-by-case basis, but not through a transaction-by-transaction review for every registered rep that meets a nebulous "particularly high" standard. The Committee believes that the exception reporting identified in the Joint Report is particularly helpful and appropriate for this point. As described in footnote 6 of the Joint Report, exception reports "help supervisors, compliance officers, and securities regulators to discover sales practice problems such as excessive switching, unauthorized trading, and other indications of securities fraud." Thus SEC and NASD appeared to agree in the Joint Report that the appropriate approach for sales practice issues such as VA exchanges was to rely on a periodic review through an exception report, rather than a transaction-by-transaction review.

E. Other Issues

The Committee also has comments on the requirement to collect information on the "life insurance holdings" of a customer and on the general interaction between the Proposed Rule and a number of disclosure-related initiatives for VAs.

Life Insurance Holdings. Proposed Rule 2821(b)(2) requires that the member firm make reasonable efforts to obtain information on the life insurance holdings of customers for a VA. The Committee believes this information provides little, if any, assistance in determining the suitability of the VA for the customer, and is an inappropriately intrusive request for irrelevant information from the customer. As

described in the Committee's 2005 Comment Letter, the "insurance" feature of a deferred variable annuity should be viewed as a feature of the investment that is different than the death benefit feature of life insurance products. While both a life insurance policy and a deferred variable annuity's death benefit will pay an amount to the beneficiary upon the death of the owner, the death benefit of the deferred variable annuity serves as a type of "financial guaranty" insurance; it provides a guarantee that, depending on the terms of the deferred variable annuity contract, the amount of premium invested will be returned despite potential market downturns. The Committee feels that element of the "death benefit" feature is often over-looked, and misunderstood, with respect to variable annuities.[19] The Committee therefore recommends that the term "life insurance holdings" be deleted from the Proposed Rule.

Disclosure Issues. As the Commission is well aware, there are a number of disclosure-related initiatives with respect to VAs that have been proposed, or are being developed, at this time. In particular, the SEC's so-called "Point of Sale/Confirm Rule,"[20] if ultimately adopted, could have a significant impact on VA disclosures that are provided to a purchaser at the point of sale. In addition, there are industry-led initiatives with respect to new disclosure approaches for VA products, including, we understand, an NASD working group effort to explore a VA "profile plus"- type document. The Committee recommends that SEC (and NASD) continue to consider how such initiatives, if implemented, would be integrated with the Proposed Rule, particularly the requirements for a registered representative to disclose the material features of a VA under Proposed Rule 2821(b)(1)(A), and whether the requirements imposed by such initiatives would result in overlapping or ineffective regulation.

[19] The Committee's 2005 Comment Letter raised this issue as well. 2005 Comment Letter at p. 7.
[20] *See, e.g., Securities Exchange Act Release No. 51274* (Feb. 28 2005).

CONCLUSION

The Committee is pleased to have the opportunity to provide comments to the Commission on proposed NASD Rule 2821 and hopes that our comments can assist NASD and the Commission in developing rules related to deferred variable annuities that are fair, sensible and appropriate for all participants in the marketplace for these products. Given the importance of the Proposed Rule to the variable annuity industry, and the nature of the comments in this letter, the Committee would be available to discuss the Proposed Rule with the appropriate personnel from the Commission, and if appropriate, NASD.

Respectfully Submitted,

SUTHERLAND ASBILL & BRENNAN LLP

W. Thom Conner EAA

BY: Eric A. Arnold

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FOR THE COMMITTEE OF ANNUITY INSURERS

Cc: The Honorable Christopher Cox
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Kathleen L. Casey
The Honorable Annette L. Nazareth
Catherine McGuire, Division of Market Regulation
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APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

AEGON USA, Inc.
Allstate Financial
The AIG Life Insurance Companies
AmerUs Annuity Group Co.
AXA Equitable Life Insurance Company
F & G Life Insurance
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
The Hanover Insurance Group
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Life Insurance Company of the Southwest
Lincoln Financial Group
Merrill Lynch Life Insurance Company
Metropolitan Life Insurance Company
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
The Phoenix Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
Sun Life of Canada
USAA Life Insurance Company