NATIONAL ASSOCIATION OF INSURANCE
AND FINANCIAL ADVISORS

July 19, 2006

Nancy M. Morris, 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 Ms. Morris:

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. 2 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. 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. The mission of AALU is to promote, preserve and protect advanced life insurance planning for the benefit of its members, their clients, the industry and the general public.

We have been active participants in the ongoing development of the Proposed Rule, and have submitted written comments to the NASD and the SEC on previous versions of the proposal. Although the current version of the Proposed Rule includes numerous amendments which were made to both the initial proposal and to Amendment No. 1, we continue to have significant concerns regarding the Proposed Rule and believe the proposal is unnecessary and would be overly burdensome. Specifically, the Proposed Rule would impose redundant specific recommendation requirements in connection with the sale of deferred variable annuities and supervisory review requirements that would 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. Under the Proposed Rule, NAIFA and AALU members who are registered representatives of broker-dealers affiliated with life insurers 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 recommendation requirements would duplicate, and in many ways go far beyond, existing 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 burdens to broker-dealers, registered representatives and consumers; and
- The NASD has not presented adequate justification for the proposed Rule. Available statistics indicate that variable annuities transactions make up a very small percentage of total disciplinary actions undertaken by the NASD.

1. <u>The Proposed Rule's recommendation requirements would duplicate, and in many ways go far beyond, requirements already in force.</u>

The Proposed Rule would both duplicate and go beyond the suitability requirements currently found in the NASD's general suitability rule, Rule 2310, which covers the activities of broker-dealers and their registered representatives. (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)). 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 not only restate the requirements already found in Rule 2310 but also impose additional requirements in connection with the making of recommendations. As discussed below, the NASD has failed to adequately demonstrate the need for a separate suitability standard for deferred variable annuities, and adopting a separate rule specifically applicable to variable annuities is therefore unnecessary and would do nothing to further the goal of consumer protection. Such differing standards could, in fact, cause confusion and misunderstanding, ultimately leading to less effective consumer protection.

In addition, while NAIFA and AALU applaud the earlier deletion from the Proposed Rule of the requirement to provide a separate "risk disclosure document" to the customer, the requirement in subsection (b)(1)(a) of the Proposed Rule that the customer be "informed of the material features of a deferred variable annuity" amounts to essentially the same requirement. Like the suitability requirement, however, this requirement would largely duplicate the disclosure of information already contained in the variable annuity's prospectus. Variable annuity prospectuses, which are reviewed by the Securities and Exchange Commission (SEC), already discuss in plain English the fees, risks and expenses associated with the product. Requiring separate, duplicative disclosures would run counter to the SEC's efforts in recent years to simplify the contents of prospectuses, and would impede the twin goals of disclosure clarity and uniformity. Instead, the NASD should focus its efforts on getting consumers to carefully read the prospectus they already receive.

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

2. <u>The Proposed Rule would impose--without an adequate demonstration of need by the NASD-- requirements on variable annuities that are not imposed on comparable investment products.</u>

The Proposed Rule would impose—without a sufficient demonstration of need by the NASD--specific suitability and principal review requirements on the sale of variable annuities, but not on other investment products which have greater amounts of NASD complaints and disciplinary procedures, such as mutual funds and hedge funds. 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 that 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 the burdens it would impose on broker-dealers, registered representatives or the product's manufacturers.

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 and 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 does not see the need to adopt specific suitability and supervisory rules for comparable investment products that have a higher incidence of NASD complaints and disciplinary actions, it is difficult to understand why new rules should be imposed on variable annuities.

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

Under the Proposed Rule, a registered principal must review and approve/disapprove every application for a deferred variable annuity within two business days of the date the registered rep transmits the application to the issuing insurance company. This rule is problematic for several reasons.

First, a strict "within two days" standard places the interests of speed before thoroughness of review. In addition, supervisors may be out of town or on vacation, and transactions could be therefore 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 "prior-to-submission" requirement contained in the initial draft of the Proposed Rule was equally problematic and unworkable.) Although we oppose the inclusion of this (or any) separate, product specific supervisory review requirement, if it is retained in the proposal it should be revised to grant a broader, more flexible review period.

Second, the Proposed Rule essentially requires the principal--with less first hand information than was available to the registered representative--to second guess the registered representative's advice and recommendations by independently determining the customer's need for the product and the product's suitability for the customer. This differs from the generally applicable supervision requirements, which require the supervisor to review the registered reps suitability determinations rather than conduct an independent determination. The Proposed Rule's requirement appears to present a bias against these products, and will lead to constant questioning of the registered representative's advice and recommendations.

These burdens are unwarranted. Variable annuities should be subject to the same review requirements as are in place for securities in general. 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. <u>The NASD has failed to demonstrate a compelling need for the Proposed Rule—the proposal is "a solution in search of a problem".</u>

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 marketplace problems sufficient to justify the Proposed Rule. The available data simply does not support the NASD's claims that sales and marketing abuses in the variable annuity marketplace warrant adoption of specific suitability and supervisory oversight rules governing deferred variable annuity sales. We understand that in recent years, unsuitable variable annuity sales have constituted less than one-half percent (.50%) 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. Similarly, the SEC receives far more complaints about mutual funds and equities than it does concerning variable annuities. 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 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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