Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re : **File Number SR-NASD-2004-183, Amendment Number 2**

Dear Ms. Morris:

Mutual Service Corporation ("MSC") is a broker-dealer member firm of the National Association of Securities Dealers, Inc ("NASD") and is a wholly owned subsidiary of Pacific Select Group, Inc. MSC is also a member of the Financial Services Institute ("FSI"). As such, please consider our comments to be in conjunction with the concerns raised by the FSI.

We at MSC appreciate the opportunity to respond to the Staff's request for comments on the proposed new Rule 2821. We understand that the objective is to create requirements for suitability determination, principal review and approval, and training related to the processing of variable annuity insurance product transactions. We commend the NASD Staff for considering the comments from the initial Amendment published July of 2005 (in the Federal Register) and making the significant edits found in Amendment No. 2. That being said, we still have some concerns about certain elements of found in Amendment No. 2.

1. Product Specific Suitability Criteria - We are concerned that the NASD believes it has to go far beyond the suitability criteria contained in its general suitability rule (Rule 2310) to establish a product specific suitability rule directed only at Variable Annuities (VAs). We believe that Rule 2310 provides satisfactory, reasonable suitability standards for all products except for those that are have higher volatility and risk associated with them. If the NASD believes that additional product-specific suitability criteria should be applied to VAs, it should develop those criteria through discussions with manufacturers and distributors of these products. It should ensure that the criteria are clear and can be applied uniformly, and either add the product specific criteria by amending Rule 2310 or add the criteria by Interpretative Memoranda ("IMs").

In addition to these general matters, we have a number of concerns about the specific suitability criteria outlined in the Proposed Rule. Paragraph (b)(2) of the Proposed Rule provides that a member must make reasonable efforts to obtain certain product specific suitability information about the customer prior to recommending a VA purchase or exchange. It seems odd to add to a listing of items that are not actually required, but potentially gathered as a result of "reasonable efforts." Although we support the NASD's listing of the specific suitability criteria necessary to support a recommendation, we are concerned that certain product specific

criteria listed by the NASD are either unclear or irrelevant to a suitability determination. MSC has the following specific concerns about the suitability criteria delineated by the rule:

- Intended Use of the Deferred Variable Annuity - We are concerned about the use of the term "intended use of the VA?" as a suitability determinant. We are unclear as to how this would apply to the purchase of a VA. We believe this question is answered by the existing request for the customer's investment objective? We feel the NASD needs to further elaborate on the meaning of this term or remove it completely from the rule.

- Existing Life Insurance Holdings - We propose that the existing life insurance holdings of the customer are not relevant to this discussion of variable annuity products. Nor should they be used as an evaluative tool for suitability determination. Life insurance is meant to create liquidity for a variety of purposes at the death of the insured. However, it does not cover the potential negative market fluctuations of any investment that the insured owned at death. The various insurance features found in variable annuities are there to guarantee streams of income and perhaps a specific payout level or non-annuitized, contract value to the beneficiary at death. Example: The client allows the values in their VA to accumulate and rise over a period of time. The client annuitizes the contract on a straight life basis, receives the first check in the mail, and has a heart attack and dies on their way back to their house. Assuming nothing further, in this example, there are no additional benefits derived from the insurance component of the contract.

2. Obligation to Inform Customers of the Material Features of the VA - Subsection (b)(1)(A) of the Proposed Rule prohibits a member from recommending the purchase or exchange of a VA to a customer unless, among other things, it has a reasonable basis to believe that the customer has been informed of specific delineated material features of VA products. We believe that the Prospectus materials already have an abundance of disclosure within them, and that any additional material may serve to confuse or obscure the information that the NASD is concerned about communicating. Indeed, in the late 80s, there was a movement for brief, plain language prospectus "highlighters" to be created to point out important information to the client about investment company products. It seems like we are moving to the other side of the spectrum by considering additional disclosure materials and we suggest this provision be stricken.

A possible solution to this issue may be to have the product-sponsor companies highlight certain sections of the prospectus materials for easier reference. Creating required uniformity as to which sections would need to be included and discussed with the client could be defined in clarification memoranda to all sponsoring companies. We believe that general disclosures are already part of the Prospectus and it is the registered representative's responsibility to walk the client through any unique way those general items are applied in the contract being considered.

3. Principal Review and Approval - The Proposed Rule requires a registered principal to review each VA purchase or exchange within two business days of the date the member transmits the customer's application to the issuing insurance company. Slow mail delivery, vacations and business travel of the customer, financial advisor, or supervisor, and other routine occurrences could easily result in the failure to meet the Proposed Rule's time frame for review. As a result, the Proposed Rule should be revised to require the completion of principal review within a reasonable time-period (not to exceed the expiration of the free look period) following the date the member transmits the VA purchase or exchange to the issuing insurance company. In addition to the foregoing, we have the following concerns about the review and approval process:

- Undue Concentration - This should be left up to the individual broker dealers based upon their supervisory structure, not a mandate.

- Deferred Variable Annuity Exchange - The Proposed Rule requires a registered principal to consider the extent to which "the customer's account has had another deferred variable annuity exchange within the preceding 36 months." The NASD should clarify this point by stating that it is the registered principal's obligation to consider prior VA exchange information if it is available to him at the time of his review. The NASD should also clarify what their expectations are (vis-à-vis continuing with the transaction or not) if the information is not available. Almost all States have their own specific replacement regulations that apply to VAs as well as life contracts. We feel that it is enough that we are in compliance with the applicable State replacement requirements.

4. Training - We agree that registered persons and their supervising principals need to understand the material features of VAs. Unfortunately, even the best training policies and materials will not "ensure" such understanding.

Registered persons need to also be appropriately licensed and appointed to sell insurance in order to transact VA business. Along with an insurance

license comes the additional, insurance-oriented continuing education burden required by their "home state."

Instead, the obligation to understand the material features of a product is part of NASD Conduct Rule 2310's requirement that a member make suitable recommendations to their client. Therefore, there is no apparent need for this additional training requirement.

We believe that the NASD should rely upon the firm element continuing education provisions of NASD Conduct Rule 1120 for the delivery of additional education. This approach would allow NASD member firms to evaluate and prioritize their financial advisors' training needs and design a program that is appropriate to the products that they offer. The NASD already has an opportunity to review the firm's training program for compliance with the minimum standards outlined in Rule 1120 when they do audits of the firm's business. Perhaps the NASD could consider a mandated training session for all persons that sell a certain threshold of VAs.

5. Unintended Consequences - The largest and potentially most problematic unintended consequence is listed above. We feel that requiring any additional disclosure items will most likely have the reverse effect of what the NASD is intending. That is, it could do more to cloud (rather than clarify) the potential features and benefits of the product to the client. Many clients may not read the existing disclosures (prospectus materials). We believe they would be equally disinterested in additional material.

We appreciate the opportunity to comment on Proposed Rule 2821. Please feel free to contact the undersigned if you have any questions or wish further clarification of our comments.

Respectfully submitted

Timothy J. Lyle
Senior Vice President and
Chief Compliance Officer