FINANCIAL SERVICES INSTITUTE

VOICE OF THE INDEPENDENT CONTRACTOR BROKER-DEALER

VIA ELECTRONIC MAIL

April 30, 2007

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

RE: SEC File Number SR-2004-283, Amendment No. 4

Dear Ms. Morris:

The Financial Services Institute[1] ("FSI") has significant concerns with Amendment No. 4 to SR-NASD-2004-183 ("Proposed Rule") filed by the National Association of Securities Dealers, Inc. (NASD) on March 5, 2007. The NASD's proposal would result in the adoption of new Conduct Rule 2821 in order to impose recommendation requirements (including a suitability obligation), principal review and approval requirements, supervisory procedure requirements, and training requirements tailored specifically to transactions in deferred variable annuities ("VAs").

Background on FSI Members

The Proposed Rule is of particular interest to FSI and its members. Our independent broker-dealer (IBD) members have a number of similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of mutual funds and variable insurance products by "check and application" direct with the mutual fund or insurance companies; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment advisory firms and/or such firms owned by their registered representatives.

Our registered representative members are independent contractors, rather than employees of the IBD firms. These financial advisors are typically located in communities where they know their clients personally and provide them investment advice in face-to-face meetings – often times over the client's kitchen table. Most of their new clients come through referrals from existing clients or other centers of influence. Due to their close ties to the community in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI members agree that VA products have many features that make them complex investments. We applaud the NASD's efforts to enhance investor protection. However, FSI members are concerned that the Proposed Rule will result in unintended consequences for those investors, financial advisors, registered principals, and broker-dealers.

[1] The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed in 2004. Our members are independent broker-dealers, often dually registered as federal investment advisors, and their independent contractor registered representatives. FSI's 104 Broker-Dealer members have more than 130,000 registered representatives serving more than 14 million American households and generating in excess of $13.5 billion in annual revenues. FSI also has more than 7,800 Financial Advisor members.

Concerns Related to the Proposed Rule

FSI is concerned that the SEC may move to adopt Amendment 3 to the Proposed Rule without the benefit of additional industry comment. We believe this would be a grave error. Despite considerable effort by the NASD to improve the Proposed Rule, many of the concerns raised by FSI and other industry commentators still have not been adequately addressed. These concerns include the following:

- Obligating financial advisors to inform clients of "various" unspecified features of all VA products without providing sufficient clarity as to those features that are considered material.
- Imposing vague product specific suitability criteria that will confuse financial advisors and their customers.
- Imposing an unrealistic and arbitrary period in which to complete the principal review and approval of VA transactions using vague review criteria, thereby emphasizing speed over diligent suitability review.
- Interfering with IBDs' ability to allocate their training resources in the most efficient and effective manner possible, thus depriving some financial advisors of training that may be more relevant to their practice and clientele.
- Increasing barriers to the sale of VAs to customers who would benefit from their valuable features, thereby reducing investor choice.

As a result of these concerns, FSI urges the NASD and SEC to obtain additional industry input prior to adoption of Conduct Rule 2821.

Detailed Comments

FSI respectfully provides the following additional comments for consideration by the NASD and SEC prior to adoption of Conduct Rule 2821:

1. Obligation to Inform Customers of Various Features VA Products – Subsection (b)(1)(A)(i) 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, in general terms, of "various" features of VAs including specific features which are delineated in the Proposed Rule. The use of the word "various" in this provision creates an unacceptable level of ambiguity. The prior proposal required the disclosure of "material" features of VAs. This language is preferable and should be reinserted into the Proposed Rule. As a result, FSI believes the language in this paragraph should be amended to read as follows:

   > (i) the customer has been informed, in general terms, of ~~various~~ the material features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities; and market risk;

2. Product Specific Suitability Criteria – 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.

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. FSI has the following specific concerns about the suitability criteria delineated by the rule:

- Investment Experience – NASD's inclusion of "investment experience" as a criterion for determining suitability should be clarified. Is it the NASD's intention that it apply to the VA itself, the sub-accounts or both? Without some guidance, the industry is exposed to future interpretation without precedent or notice. Further, is it the NASD's perspective that no prior investment experience renders a purchase recommendation unsuitable?
- Intended Use of the Deferred Variable Annuity – FSI remains concerned about the use of the term "intended use of the VA?" How is this different from the customer's investment objective? Is either estate planning or tax deferral a legitimate "intended use" or would the NASD require a more detailed analysis? FSI asks that the NASD further elaborate on the meaning of this term or remove it completely from the rule.
- Existing Assets – The Proposed Rule has been amended to require the financial advisor to make reasonable efforts to obtain information concerning the customer's "existing assets (including investment and life insurance holdings)…" This language is overly broad in that it could potentially require representatives to obtain information about assets that have no impact on the suitability of their recommendation (e.g., automobiles or jewelry owned by the customer). FSI recommends that the requirement be amended to obligate the representative to make reasonable efforts to obtain information concerning the customer's "investable assets."

3. Principal Review Standard – Paragraph (c) of the Proposed Rule requires a registered principal to "review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity." The Proposed Rule goes on to say that "a registered principal shall approve the transaction only if the registered principal has determined that there is a reasonable basis to believe that the transaction would be suitable" based upon the suitability criteria delineated in the recommendation requirements of the rule. This language obligates the registered principal to make a separate suitability determination thereby placing him/her in the same shoes as the financial advisor making the sale without the benefit of meeting with the client to discuss their financial situation and objectives. This appears to be a significant deviation from the requirements of 3010(d)(1) which states in relevant part:

> Each member shall establish procedures for the review and endorsement by a registered principal in writing, on an internal record, of all transactions… Such procedures should be in writing and be designed to reasonably supervise each registered representative. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to the Association upon request.

As a result, FSI believes the language in the Proposed Rule paragraph should be amended to read as follows:

> (c) …a registered principal shall ~~review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity. Subject~~

~~to the exception provided below, and treating all transactions as if they have been recommended for purposes of this principal review, a registered principal shall approve the transaction only if the registered principal has determined that there is a reasonable basis to believe the transaction would be suitable based upon~~ consider the factors delineated in paragraph (b) of this rule in considering whether to approve or disapprove of the purchase or exchange of the deferred variable annuity…

4. Time Frame for Principal Review and Approval – The Proposed Rule requires a registered principal to review and determine whether he/she approves of a VA purchase or exchange "[p]rior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business after the customer signs the application…". This limited principal review period raises two specific concerns for FSI members. First, imposing a specific timeframe places the emphasis on speed rather than on a diligent suitability review. Customer service concerns and fear of liability associated with market movement during the review period already insure that financial advisors and broker-dealers are appropriately motivated to perform a prompt review. Establishing an arbitrary timetable simply increases the recordkeeping burden on broker-dealers without any demonstrable benefit to clients. Second, the proposed principal review period sets a trap for unsuspecting fully computing broker-dealer firms. While the NASD has announced its intention to seek no-action relief from SEC Rules 15c3-1 and 15c3-3 for introducing broker-dealer firms who are holding an application and check for a VA purchase for the purposes of principal review, there is no indication that fully computing firms would receive similar relief from these customer protection obligations. As a result, fully computing firms who do a sizeable amount of VA business are likely to be required to maintain enormous reserves. This would place an unreasonable burden on fully computing firms. The NASD has struggled mightily to find an appropriate consistent time frame in which to require the completion of principal review. Unfortunately, none of the previously proposed options appears viable. As a result, FSI believes the NASD should take a principle based approached to the review time period. The Proposed Rule should be revised to require the prompt principal review of VA purchases or exchange while allowing member firms to design appropriate systems to accomplish the task.

5. Variable Annuity Exchange Supervisory Procedures – Paragraph (d) of the Proposed Rule requires member firms to "implement surveillance procedures to determine if the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions" of the Proposed Rule. FSI objects to this requirement because the information may be unavailable to our members due to a client's reluctance to share such information or the legitimate privacy policy concerns of the prior broker-dealer or insurance company. As a result of these concerns, the NASD should amend the Proposed Rule 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. However, if the SEC and NASD choose not to amend the Proposed Rule in this fashion, FSI asks that they provide additional clarification concerning its requirements. Specifically, what does the term "rate of … exchanges" mean? Does the NASD mean to refer to a percentage of the financial advisor's total VA business or instead to a percentage of the financial advisor's customer base? What is the relevant period for measuring the rate of exchanges? What is the yardstick by which a financial advisor's rate of exchanges should be compared to determine whether it is high? What is a member to do if it believes the individual

exchange transactions to be suitable although they have occurred at a high rate? Finally, this provision is particularly troublesome to FSI members as it seems to suggest that broker-dealers have the technology available to be able to monitor this exchange activity. Many of FSI's members simply do not.

6. Training – In general terms, FSI supports the NASD's desire to increase the knowledge and awareness of financial advisors and principals who are involved in the sale or approval of VA transactions. These are complex products and their features and internal costs vary widely. It is important for representatives and principals to fully understand the product features to ensure they meet the client's specific needs. Nevertheless, FSI remains concerned about the Proposed Rule's training requirements that member firms develop training policies and programs "reasonably designed to ensure" that financial advisors and registered principals involved in the sale and supervision of VA products comply with the requirements of the Proposed Rule and understand the material features of VAs. Unfortunately, even the best training policies and materials will not "ensure" such understanding. Instead the obligation to understand the material features of the product a financial advisor sells to his client is inextricably bound up in the Proposed Rule's requirement that a member make suitable recommendations to his client. Therefore, there is no apparent need for this additional training requirement that will merely serve to create new books and records obligations for member firms. In addition, FSI notes that several recent NASD rule proposals (e.g., the gifts and business entertainment proposal contained in NtM 06-06) have sought to impose separate and unique training requirements. FSI believes that the NASD should refrain from educational mandates and instead rely upon the firm element continuing education provisions of NASD Conduct Rule 1120. This approach allows NASD member firms to evaluate and prioritize their financial advisors' training needs and design a program that is appropriate to the task. The NASD would then have the opportunity to review the firm's training program for compliance with the minimum standards outlined in Rule 1120. If the firm's financial advisors engage in a significant volume of VA transactions, the training program would be required to focus significant attention to the general investment features and risk factors associated with these products. If, however, the firm's financial advisors do not sell VA products, or have not been the subject of VA related complaints or arbitrations, resources could be dedicated to training on more relevant topics. In this way, IBD firms can more effectively allocate their training resources to address the unique needs of their firms.

7. Unintended Consequences – FSI fears that the Proposed Rule will ultimately harm customers by raising barriers to their access to VA products. Singling out VAs for more stringent suitability requirements is likely to inhibit the sale of this important financial product. Financial advisors may unconsciously "choose" to offer less suitable products because of the additional paperwork, procedures, and supervisory review involved in the sale of VAs. The result may very well be that VAs become less available to those who could benefit from them as legitimate vehicles for tax-deferred savings, estate, and retirement planning. FSI recognizes that there have been some serious abuses involving the sale and exchanges of VAs. However, we do not believe the sales abuses have occurred because the NASD's rules and enforcement mechanisms were not strong enough to prevent them. Therefore, FSI urges the NASD to place additional emphasis on the enforcement of the existing Conduct Rules. In addition, FSI believes that more meaningful disclosures to customers via sponsor-created prospectuses or a disclosure document suggested by the NASD Annuity Roundtable working groups will ultimately help to eliminate most sales practice abuses.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,

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Executive Director & CEO

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Honorable Paul S. Atkins
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