



NASAA

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September 20, 2005

VIA EMAIL: rule-comments@sec.gov

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

**RE: Proposed Rule Governing the Purchase, Sale, or Exchange of Deferred Variable Annuities; NTM 04-45 and File No. SR-NASD-2004-183**

Dear Mr. Katz:

This letter is submitted by the North American Securities Administrators, Inc. (NASAA) in response to the latest amendments to the Proposed Rule Governing the Purchase, Sale, or Exchange of Deferred Variable Annuities.

**A. The Proposed Rule Should Cover All Variable Annuity Transactions, Not Just Deferred Variable Annuity Transactions**

NASAA supports a rule dealing specifically with Variable Annuities. For many years now, Variable Annuities sales practice violations have been in our Top Ten Scams, Schemes and Scandals. Sales practice violations and inadequate supervisory policies and procedures designed to prevent and detect such violations as to the sale or exchange of Variable Annuities have been a major concern for all securities regulators.

NASAA takes this opportunity to reiterate our position that the proposed Rule should also cover the sale of an immediate variable annuity as well as a deferred variable annuity. A member must have the same reasonable basis in fact in recommending this type of variable annuity, and the investor has the same legal right to be informed of the costs and risks associated with its purchase. We further believe that NASD members have the same legal responsibilities of principal review, documentation, and supervisory requirements as specified in Rule 3010 and 3110 for an immediate variable annuity. Because NASAA views the requirements and legal responsibilities surrounding immediate and deferred variable annuity transactions as equivalent, the proposed Rule should include provisions expressly governing all variable annuity transactions.

## **B. Exemption for Tax-Qualified, Employer-Sponsored Retirement or Benefit Plans**

Proposed Rule 2821(a)(1) does not apply to deferred variable annuity transactions made in connection with tax-qualified, employer-sponsored retirement or benefit plans that either are defined as a “qualified plan” under Section 3(a)(12)(C) of the Exchange Act or meet the requirements of Internal Revenue Code Sections 403(b) or 457(b). NASAA recommends a qualification of this exemption from the proposed rule for qualified plans that primarily rely on the recommendations of the member or associated person. Where the qualified plan sponsor, trustee or custodian is either unsophisticated or primarily relies upon the recommendations of the member or associated persons, the proposed rule should apply regarding recommendation requirements, principal review, supervision and training.

## **C. Risk Disclosure Document**

The revised rule no longer requires a “(s)eparate, brief and easy to read (written in “plain English”) risk disclosure document...” which would be provided to the client prior to effecting any sale. NASAA recommends this risk disclosure document be required.

Variable annuities are complex investment products as evidenced, in part, by the high rate of investor complaints indicating that investors do not understand the mechanics of variable annuities. A potential investor is significantly more likely to read a brief and easy-to-read disclosure document containing the salient points regarding the mechanics of the instrument. As a result, such a document is an important element in the prevention of sales practice and suitability violations.

The purpose of such a risk disclosure document must be to inform prospective investors about the basic facts of the instrument and the risks attendant thereto. Product specific information is essential because it assists potential investors in understanding the mechanics of each specific product such as fees, liquidity, and taxes. Along with general information about variable annuities, such information allows investors to make informed decisions and determine whether such products are suitable investments. For these reasons, NASAA takes the position that a separate risk disclosure document must be provided to the investor prior to any sale and *in addition* to the prospectus.

## **D. Recommendation Requirements**

NASAA agrees with and commends the NASD for including the requirement under proposed Rule 2821 (b)(1)(C) that the member or associated person has a reasonable belief that the investor has a need for the features of a variable annuity as compared with other investment vehicles and that the registered principal under proposed Rule 2821(c)(1)(A) reviews for such comparison. *See also*, proposed Rule 2821(d)(1). NASAA believes that unless such comparisons are made available, investors cannot make reasonable and informed decisions regarding the purchase or exchange of the variable annuity product.

**E. Principal Review Should Include a Periodic Review of the Associated Person's Production Report for Variable Annuities**

NASAA agrees with the revised deadline of principal review under proposed Rule 2821(c)(1) that prior to transmitting an investor's application for a deferred variable annuity to the issuing insurance company for processing and regardless of whether the transaction has been recommended, a registered principal shall review and determine whether he or she approves the purchase or exchange of the deferred variable annuity. This new deadline would ensure that the principal has enough time to do a complete review of the application while still preserving the investor's free look period.

NASAA also agrees with the NASD proposed requirement under the Rule that the member must implement procedures to screen for and require a registered principal's review of a deferred variable annuity transaction where the associated person effecting the transaction has a particularly high rate of effecting deferred variable annuity exchanges. However, NASAA takes this opportunity to reiterate our view that the registered principal be required to review the total production attributable to variable annuities of associated person(s). This would permit the registered principal to detect possible patterns of sales practice violations and other potential abuses that reviews on a sale-by-sale basis may not reveal.

NASAA agrees with the requirement that members review both recommended and non-recommended variable annuity transactions. The complexity of the product and abuses by associated persons necessitate principal review of all variable annuity transactions.

**F. If Hypothetical Illustrations are Used, the Rule Should Require Illustrations That Are Not Misleading**

NASAA reiterates its proposal that the Rule should include a provision that specifically addresses the use of hypothetical illustrations in variable annuity transactions. NASAA shares the NASD's concern that some tax-deferral illustrations may rely upon incorrect or misleading assumptions. NASAA members have also experienced problems with agents improperly using general mutual fund illustrations instead of illustrations regarding specific variable annuity sub-accounts, i.e., using the net asset value (NAV) of the parallel retail mutual fund instead of the accumulated unit value (AUV) of the variable annuity sub-account in illustrating a hypothetical performance.

The problem arises because investments through a variable annuity sub-account and through the retail mutual fund are not the same. Consequently, investors are likely to be misled about, among other things, the expenses associated with the variable annuity and the sub-account(s). The proposed rule should require member firms to review on an ongoing basis marketing communications that use hypothetical illustrations. Even absent a specific rule, firm training policies and programs should ensure that hypothetical illustrations fully and fairly disclose all of the material features of variable annuities and sub-accounts.

Thank you for your consideration of NASAA's views on these issues. If you have any questions regarding these comments contained in this letter, please do not hesitate to contact Tanya Solov,

Director of the Illinois Securities Department and Chair of NASAA's Broker-Dealer Section  
([tsolov@ilsos.net](mailto:tsolov@ilsos.net)), or John Cronin, Chair of the Broker-Dealer Variable Annuities Project Group  
([jcronin@bishca.state.vt.us](mailto:jcronin@bishca.state.vt.us)).

Sincerely,

A handwritten signature in black ink, appearing to read 'Patricia D. Struck', with a long horizontal stroke extending to the right.

Patricia D. Struck  
NASAA President and  
Wisconsin Securities Administrator