

# Public Investors Arbitration Bar Association

July 20, 2006

Nancy M. Morris, Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Robert S. Banks, Jr.  
President

Re: File No. SR-NASD-2004-183

Steven B. Caruso  
Vice-President/  
President-Elect

Dear Ms. Morris:

Brian Smiley  
Secretary

Please accept the following as the comments of the Public Investors Arbitration Bar Association ("PIABA") to Amendment No. 2 to the above-referenced rule (the "Proposed Rule").

Scot Bernstein  
Treasurer

PIABA previously filed its comment letter dated September 9, 2005, to the original filing of the Proposed Rule.

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PIABA strongly supports the proposed increased regulation of the sale of deferred variable annuities based upon the abuses cited in our September 9, 2005, comment letter.

## Omission of Commissions as Disclosure Item

PIABA supports the specific Recommendation Requirements as described in subsection (b) of the Second Amendment. These requirements establish prescribed disclosures by members and associated persons recommending the purchase or exchange of deferred variable annuities.

PIABA, however, is concerned that the NASD has omitted disclosure of commissions from the mandated items.

Substantial commissions for the sale of deferred variable annuities are paid by the insurance company to the agent and are recovered by the insurance company through surrender charges and additional fees charged in the policy. The variable annuity prospectus and other disclosure materials provided to the investor do not disclose commissions received by the agent. This is in contrast to general securities and mutual fund sales where commissions are prominently disclosed.

PIABA members have represented hundreds of investors who have filed complaints in connection with their purchase of variable annuities. Our experience is that investors, unable to find commission disclosure in their documents, often ask the selling agent, "What are you getting paid?" Typically, the agent responds, "You don't have to worry. The insurance company is paying me." This response is an intentional omission to disclose and conceals the substantial commission which the agent receives to induce the sale.

Robin S. Ringo  
Executive Director

Mark E. Maddox  
Director Emeritus

The fact that variable annuity commissions are not disclosed was referenced in the July 16, 2006, Parade magazine which described variable annuities as "the one investment you should avoid." The article states that new annuity sales currently are \$18 billion-plus per month and are expected to accelerate dramatically. Parade reports that commissions can run as high as 12 percent of the money invested and cites reports of federal and state regulators that commissions are often not disclosed.

The size of variable annuity commissions comes as a shock to most investors. The clients of our members commonly react that had they known their brokers were earning such large fees (often tens of thousands of dollars for just a few hours' work), they would not have purchased the annuities.

The materiality of commission disclosure to annuity sales is beyond debate.

PIABA believes that an NASD rule which allows the selling agent to conceal the commission facilitates a material omission under the anti-fraud statutes and a breach of duty at common law.

### **Brokers' Legal Duty to Disclose Commissions**

The SEC has prosecuted brokers for taking undisclosed compensation. See, e.g., SEC Release Nos. 33-7785, 34-42243 (Dec. 17, 1999) (registered representative's failure to disclose to customer that he has received or will receive compensation to recommend a security violates Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder); SEC Release No. 34-36620, 60 SEC Docket 2502 (Dec. 21, 1995). See also SEC Release Nos. 33-7635, 34-40984 (Jan. 27, 1999) (broker has duty to disclose conflicts of interest; accepting undisclosed fee violated the securities laws); Stone v. Kirk, 8 F.3d 1079, 1087 (6th Cir. 1993) (substantial commissions paid to a selling agent is a material fact which should be disclosed to investors, particularly where knowledge of the commissions may deter an investor from making an investment).

The principle that a broker receiving a substantial commission has an obligation to disclose his personal interest in the transaction was recognized decades ago by the eminent Louis Loss when he wrote the following:

When one is engaged as agent to act on behalf of another, the law requires him to do just that. He must not bring his own interests into conflict with his client's. If he does, he must explain in detail what his own self-interest in the transaction is in order to give his client an opportunity to make up his own mind whether to employ an agent who is riding two horses.

Louis Loss, *The SEC and the Broker-Dealer*, 1 Vand. L. Rev. 516, 522 (1948).

PIABA believes it is essential that the NASD require selling agents to disclose their commissions to investors in connection with recommending variable annuity purchases and

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exchanges and that this disclosure should be included in subsection (b) of the Second Amendment to the Proposed Rule.

Very truly yours,



Robert S. Banks, Jr.  
PIABA President

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RSB:ms