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BY HAND

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Re: File Number SR-NASD-2004-183; Release No. 34-52046A
Proposed Rule Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities

Dear Mr. Colby and Ms. McGuire:

We would like to express our thanks to each of you and to the other members of the staff (the "Staff") of the Securities and Exchange Commission (the "SEC" or "Commission") for meeting recently with representatives of the Committee of Annuity Insurers,[1] NAVA,[2] and the ACLI.[3] The Staff agreed to the meeting in response to a request from each organization to meet to discuss our concerns regarding proposed

[1] The Committee of Annuity Insurers is a coalition of 30 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over half of the annuity business in the United States.

[2] The National Association for Variable Annuities (NAVA) is a not-for-profit organization dedicated to the growth and understanding of annuity and variable life insurance products. NAVA represents all segments of the annuity and variable life industry with over 350 member organizations, including insurance companies, banks, investment firms, distribution firms, and industry service providers.

[3] The American Council of Life Insurers (ACLI) is a national trade association with 356 members representing 80 percent of all United States life insurance companies as measured by total assets, and reflecting 84 percent of total annuity considerations and 78% of total insurance premiums.

request from each organization to meet to discuss our concerns regarding proposed NASD Rule 2821, which was published recently for public comment by the Commission.[4] As you know, Rule 2821 would create recommendation requirements (including a heightened suitability obligation), expanded principal review and approval requirements, and supervisory and training requirements that would apply solely to sales and exchanges of deferred variable annuity contracts.

From the industry's perspective, the meeting afforded a critical opportunity to articulate in greater detail the serious concerns expressed in each organization's comment letter. The meeting also provided a valuable opportunity for the industry to better understand the regulatory concerns driving the proposed rule and to explore with the Staff possible alternative ways to address those concerns.

To further assist the Staff in its ongoing consideration of proposed Rule 2821, this letter summarizes the industry's concerns expressed at the meeting. As you may recall, the concerns expressed were essentially twofold – concerns about the rule generally, as well as concerns about three specific provisions of the rule that we believe are particularly misguided. Each of these concerns is discussed in detail below.

We believe it is also important to note that the three different organizations expressed other concerns and made other points in their respective comment letters. Each of these concerns and issues are important, and we believe they each warrant continued consideration by the Staff in its deliberations regarding Rule 2821.

I. The Industry's General Concerns

As we noted at the meeting, the industry is steadfast in its view that there is simply no place for unsuitable sales of variable annuity contracts. For this reason we believe the NASD should continue to strictly enforce its existing suitability and supervisory rules. In this regard, we recognize that the NASD proposed Rule 2821 for the purpose of providing an additional tool to ensure suitable variable annuity contract sales. The rule goes too far, though, and could be detrimental to investors by substantially impairing the marketability of variable annuity contracts.

We believe that are two primary causes for concern. First, the rule would impose compliance obligations on broker-dealers selling variable annuities that are significantly more burdensome than requirements governing the sales of most other securities, including mutual funds and general securities products, without commensurate benefit to

[4] *See Self-Regulatory Organizations; National Association of Securities Dealers; Notice of Filing of Proposed Rule and Amendment No. 1 Thereto Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities; Corrected,* Securities Exchange Act Release No. 52046A; File No. SR-NASD-2004-183 (July 19, 2005), 70 Fed. Reg. 42,126 (July 21, 2005) (the "Proposing Release").

investors. Additionally, the rule could expose NASD member firms to a significantly greater risk of unwarranted private litigation. While this risk may be viewed as speculative and therefore not a sound underpinning for establishing regulatory policy, it is a factor that NASD member firms consider when making business decisions about what financial products to offer. Given the critical role variable annuities can play in helping to solve America's looming retirement crisis by providing guaranteed lifetime income in combination with other types of unique guarantees, unduly compromising the willingness of firms to offer the products cannot be in anyone's best interests.

In this regard, we believe several important facts bear restating. The NASD has not provided empirical data supporting its claim that there are widespread sales practice problems necessitating a special variable annuity sales practice rule. NASD also has not conducted a cost-benefit analysis weighing the increased costs of the proposed rule against expected additional investor protections. Indeed, proposed Rule 2821 may impose substantial economic or competitive burdens on the variable annuity industry. The NASD's proposal contains no economic impact statement, and does not quantify the burdens on broker-dealers or variable contract issuers under the proposed changes. The economic and competitive burdens of the proposal are fundamental considerations the Commission must fulfill in reviewing and approving this specific NASD initiative. The NASD's request for self-regulatory organization (SRO) rule approval does not fulfill these important statutory goals to protect both competition and investors and thus increases the risk of unintended harm to investors and member firms.[5]

The variable annuity industry believes strongly that singling out variable annuities for a special suitability rule is unsound from a regulatory standpoint. Adopting this type of rule would be contrary to the NASD's and the Commission's own approach even in the wake of identifying serious sales practice problems. For example, neither the NASD nor the SEC adopted special suitability rules in the wake of the widely-reported problems associated with the sale of mutual fund B-shares. Instead, NASD and SEC provided guidance to the industry that has effectively addressed the problem. The NASD provided similar guidance to the variable annuity industry in the form of the "best practices" published in Notice to Members 99-35. We believe this guidance was sound and would urge the Commission to permit it to stand. Otherwise, the imposition of another set of requirements under Rule 2821 could require firms to divert resources away from their established sales practice procedures to developing new procedures to comply with the rule.

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[5] In this regard, we note that the Securities Act Amendments of 1975 significantly expanded the Commission's oversight and regulatory powers concerning SRO rules, and specifically directed the Commission to carefully evaluate competitive factors in exercising its SRO oversight. In order for Commission review to provide immunity for self-regulatory conduct, the review must be active, and must result in a ruling by the Commission that is judicially reviewable.

II. Principal Pre-Approval Requirement

Rule 2821 would require that a registered principal review and approve a deferred variable annuity purchase or exchange prior to transmitting the customer's application to the issuing insurance company for processing. There are two important negative aspects of this proposal.

First, a principal pre-approval requirement would in many cases delay the investment of customers' purchase payments. Investors that purchase variable annuity contracts expect the same prompt pricing they would get if they purchased mutual funds or general securities products. Applicable SEC and the NASD rules also require prompt pricing. For these reasons industry processing systems have been designed to ensure that customers are priced into variable annuity contracts as expeditiously as possible. Subjecting variable annuities to a unique principal pre-approval requirement would frustrate investor expectations, deviate from current regulatory policy that customers' funds be invested immediately, and send a message to broker-dealers and their customers that variable annuities are an inherently risky type of investment.[6]

Second, a principal pre-approval requirement would place a premium on speed over quality. We believe this would be counterproductive, because there should always be sufficient time permitted to conduct a high-quality principal review. In fact, because the suitability review process for variable annuities is multifaceted the review process can take longer than for other types of securities. That is, variable annuity suitability determinations typically involve a review of the overall suitability of the annuity contract, the underlying investment options selected by the customer, and the optional guarantee features that have been elected. Customer outreach is increasingly part of these reviews, and conducting such calls often is time-consuming. We are concerned that if registered principals are not given enough time to conduct thorough reviews, there will be a tendency to conduct fewer outreach calls, fewer trades will be broken, and fewer contract adjustments will be made (*e.g.*, reallocations of the underlying investment options and selection or de-selection of optional insurance features).[7]

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[6] Options and futures transactions are the only other types of transactions we are aware of that are subject to a principal pre-approval requirement. Options and futures are strikingly different from variable annuities because investors can lose their entire investment. We believe that placing variable annuities in the same investment risk category as options and futures would foster a gross misperception of the level of risk associated with variable annuities.

[7] With respect to the Staff's request for data quantifying the current rate of variable annuity transaction reversals, our review disclosed that there is no standard data capture mechanisms employed by the industry (nor is any such data capture required under applicable recordkeeping rules); this may be due at least in part to the fact that transactions can be rejected at various stages of the application process and firms may therefore not find it to be particularly useful to keep statistics regarding the rate of rejections that occur just at the point of formalized suitability review.

For the above reasons, we believe that the suitability review and contract issuance processes should continue to be permitted to progress on separate tracks. The goal should be to make sure that both processes are robust, but not to make the pricing in of a customer's purchase payment contingent upon principal review of suitability. We believe that the SEC's and the NASD's regulatory goals would be far better served by subjecting principal approval to a "prompt" requirement. Requiring variable annuity principal reviews to be conducted promptly would address the NASD's concern that there not be long delays in suitability analyses or that such analyses not occur long after an insurance company issues a variable annuity contract,[8] while at the same time permitting principals to continue to focus on the quality of their suitability reviews.

III. Comparative Need Requirement

We believe that the recommendation requirements of subparagraphs (1), (2) and (3) of paragraph (b) of proposed Rule 2821 generally are unprecedented, counter-productive and overbroad, and will pose numerous practical difficulties for broker-dealers offering variable annuity contracts. Two of the recommendation requirements, that the NASD member firm or the associated person have a reasonable basis to believe that the customer has a need for the features of a deferred variable annuity as compared with other investment vehicles, and that the customer have a long-term investment objective, are particularly problematic. The comparative needs requirement is discussed in this section, and the long-term investment objective requirement is discussed in the following section.

As a threshold matter, we note that it is unprecedented to suggest that the suitability of a particular investment product be measured by a comparison with other products. To our knowledge, no other financial product has ever been required to be "more suitable" than others.

Equally important, an assessment of an individual's "needs" in terms of insurance must take into account not only the specific financial goals of an individual contractowner, but also what types of guarantees the contractowner may *want* in order to become comfortable in engaging in an investment strategy that is not inappropriately conservative. Rule 2821's proposed comparative need requirement, on the other hand, raises grave concerns because in situations when years have passed and a contractowner has not drawn upon a guarantee, the broker-dealer could well be subjected to claims that in hindsight the guarantee was not "needed."

Moreover, the assessment of customer "need" in this context could be extremely subjective. Neither Rule 2821 nor the Proposing Release give any guidance as to how a

[8] *See* Proposing Release, Section C, "Self-Regulatory Organization's Statement on Comments on the Proposed Rule Received from Members, Participants, or Others."

representative would be expected to go about making this assessment. Finally, there is no evidence that the general NASD suitability standard in Rule 2310(a) (requiring a broker-dealer or associated person to have reasonable grounds for believing that a securities transaction is suitable for a client based on the facts, if any, disclosed by the client as to his or her other security holdings and as to his or her financial condition and needs) is insufficient.

We note additionally that the Commission's disclosure rules and forms have never been designed to facilitate comparison of one kind of product (*e.g.*, variable annuity contracts) with another (*e.g.*, mutual funds). Further, the NASD has in other contexts placed strict constraints on the manner in which comparisons between different types of investment may be made. *See, e.g.*, NASD Conduct Rule 2210(d)(2)(B) and IM-2210-2 (requiring comparisons among products to "disclose all material differences between them"). Rule 2821 would turn this regulatory construct on its head by encouraging comparisons between variable annuities and a wide variety of financial products, without any rules or guidance on how to do so.

It is also unclear what types of other financial products would need to be included in comparisons. Some registered representatives may offer a broad range of financial products such as retail mutual funds, general securities, fixed annuities, variable life insurance, and certificates of deposit, while other registered representatives may offer a more limited range. In the latter situation, it could be difficult for registered representatives to make comparisons because they would be required to learn about features of products that they do not sell in order to include them in a comparison.

Many of the insurance features of variable annuities (including guaranteed lifetime income, guaranteed minimum death benefits or "GMDBs," guaranteed minimum income benefits or "GMIBs," guaranteed minimum withdrawal benefits or "GMWBs," and other types of guarantees) are unique to variable annuity contracts, and there are not guarantees readily comparable in other types of products. We believe it is incongruous to suggest that unique features of a variable annuity should be compared to other financial products that do not have such features.

We note that the "comparative need" requirement of Rule 2821 has been perhaps its most controversial provision. A requirement like this is simply contrary to long-established suitability tenets reflected in both the Commission's and the NASD's rules and should be eliminated.

IV. Long-Term Investment Objective Requirement

Rule 2821 would require NASD member firms or their associated persons to have a reasonable basis to believe that a customer to whom a deferred variable annuity purchase or exchange is recommended has a "long-term investment objective." This

"one-size-fits-all" approach is not sound, because the standard of "long-term" is nebulous and will depend on the particular circumstances of the individual customer.

Additionally, it is important to recognize in this regard that not all variable annuity contracts are designed for customers who have such a long-term investment objective. Many variable annuity contracts are designed for customers with greater liquidity needs and hence are offered without surrender charges, lower surrender charges or shorter surrender periods (*e.g.*, 3 or 4 years), surrender charge waivers (*e.g.*, for contractowners who are confined to nursing homes), and/or with annual free withdrawal amounts or guaranteed minimum withdrawal features under which withdrawals are expected to begin shortly after contract issuance. Indeed, one of the fastest-growing types of variable annuity contract is characterized by a load structure with a shorter term. Given the availability of these types of products, the long-term or short-term nature of the customer's investment objective is less relevant in assessing suitability than the customer's liquidity needs as compared to the features of the variable annuity contract (given, of course, that other considerations such as potential tax penalties on early withdrawals do not predominate).

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We would again like to express our thanks to the Staff for agreeing to meet in person to discuss the industry's concerns regarding proposed NASD Rule 2821. We believe the proposed rule is severely flawed. The three provisions discussed in this letter are particularly unworkable and may present the most serious risk of unintended harm. However, as noted above, each organization's comment letter took varying positions on and made different points with respect to the other provisions of the rule, and we believe each of these letters warrant continued careful consideration. As we noted at the meeting, if the rule were to move forward we believe that the substantial revisions to or

elimination of the provisions discussed above that would be necessary to make the rule workable, dictate that the rule be reproposed for public comment.

Sincerely Yours,

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for the Committee of Annuity Insurers

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