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June 8, 2006

Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-9303

RE: File No. SR-NASD-2004-183; *Amendment No. 2 to Proposed NASD Rule 2821 Concerning Supervision and Suitability in the Sale of Variable Annuities; Extensive Comment Period Needed.*

Dear Ms. Morris:

We write in response to Amendment No. 2 to proposed NASD Conduct Rule 2821. The rule would create a suitability obligation, principal review and approval requirements, and supervisory and training requirements tailored to transactions in deferred variable annuities. NASD's Amendment No. 2 requests SEC approval of the rule prior to the 30th day after its publication in the Federal Register, and requests that the SEC accelerate the effectiveness of the rule prior to the 30th day after its publication in the Federal Register.

The American Council of Life Insurers (ACLI) strongly urges the SEC to decline the NASD's request for accelerated approval and effectiveness of proposed Rule 2821. The rule has witnessed a complex and controversial administrative history with extensive commentary. The NASD's Amendment No. 2 has not fully addressed significant comments, and introduces new concepts and procedures that warrant an extensive public comment period. The proposal may have an anticompetitive impact on broker-dealers distributing variable annuities. It is far more important, therefore, to allow thorough input on the initiative than to race toward a regulatory finish line.

ACLI is a national trade association with 377 members that account for 91 percent of the industry's total assets, 90 percent of life insurance premiums, and 95 percent of annuity considerations. Many of our member companies offer and distribute variable annuities, variable life insurance and mutual funds directly or through affiliated and independent broker-dealers. Over 50% of the NASD's 659,202 registered representatives work for broker-dealers affiliated with life insurance companies. The initiative would have a significant impact on our industry.

We have actively participated in a numerous NASD rulemaking initiatives. SEC oversight of SRO rule proposals ensures balanced regulations in the public interest, and provides an important protection against SRO rules that may impede competition. The full execution of SEC oversight and public comment is fundamental to sound rulemaking.

Our member companies and their broker-dealer affiliates have concerns with the NASD's proposed variable annuity suitability and supervision rule. The nominal 21-day comment period requested in NASD's amendment No. 2 provides neither adequate opportunity for meaningful analysis of the proposal, nor a meaningful time within which to formulate comments for submission. Accordingly, the SEC should establish a reasonable opportunity to provide input on the proposed amendments.

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The recent modifications to the proposal merit thorough discussion and analysis. The rule's amendments are significant and have been evolving since August 2004, when the NASD invited comment on the initiative from its membership. The release does not reference any emergency regulatory situations needing immediate action. The fundamental focus of the rule amendments is currently addressed by various NASD rules and Notices to Members. A regulatory void, therefore, does not exit. Active public input should not be shortchanged.

A 21-day comment period is insufficient to address the issues raised in the release. As a practical matter, most observers will have fewer than 21 days to digest the proposal following its Federal Register printing date due to time consumed in delivery and dissemination of the Federal Register. Moreover, the comment period will likely occur during the peak of the summer vacation season, which reduces the initiative's exposure to scrutiny. Some of the provisions appeared for the first time in Amendment No. 2, and will require substantial time to analyze.

These factors support a reasonable comment period and the avoidance of accelerated approval and effectiveness that the NASD requests. Industry groups like our trade association circulate regulatory proposals, elicit membership input, develop a consensus, and circulate a draft letter of comment before submission. This is a worthwhile, but time intensive, process that is difficult to execute in 21 days.

The special time burdens confronting regulated industries and large organizations in digesting regulatory proposals were explicitly recognized by the Administrative Conference of the United States in its publication entitled *A Guide to Federal Agency Rulemaking*, which observes:

> The 60-day period established by Executive Order 12044 for significant regulations (and no longer in effect unless adopted by agency rule) is a more reasonable *minimum* time for comment. However a longer time may be required if the agency is seeking information on particular subjects or counter-proposals from regulated industry. *"Interested persons" often are large organizations and they need time to coordinate and approve an organizational response or to authorize expenditure of funds to do the research needed to produce informed comments.*[1]

The NASD itself spent nearly eight months (approximately 240 days) analyzing and revising the proposal after the initial comment period ended. In light of this lengthy time period for NASD review of the proposal, industry commentators should be entitled to a reasonable period of comment longer than 21 days.

There are several additional reasons that a comment extension should be granted:

- The SEC's September 2005 invitation of comment on the proposal elicited 1,500 letters of comment.[2] A significant number of commentators opposed all or parts of the rule for a variety of reasons. Amendment No. 2 does not resolve important areas of concern expressed in the record.

- Notwithstanding the assertion in Amendment No. 2 that the NASD has considered the rule's impact on competition, some of the changes in the proposal could unreasonably

[1] *See, A Guide to Federal Agency Rulemaking* (1983) at 124 (emphasis added).

[2] According to the initial release, only fourteen of the commentators fully supported the proposal, and twenty offered partial or qualified support. Using the NASD's numbers, approximately 97% of the commentators opposed the original initiative. This volume of negative comment was a lightning rod for broad regulatory concern. Given the scope of the issues and the range of commentators, the amended proposal merits a functional opportunity for evaluation.

burden competition. A long comment period will allow the SEC to execute its responsibilities under the Securities Exchange Act to evaluate SRO impairments to competition. Congress provided guideposts to evaluating proposed rulemaking under the Exchange Act. Section 23(a) of the Exchange Act requires the SEC to consider the anti-competitive effects of rule changes, and to balance any impact against the regulatory benefit to be obtained. Accelerated approval and effectiveness periods do not allow commentators to address significant concerns about the proposal's impact on competition.

- The proposed rule may have a significant negative impact on broker-dealers affiliated with life insurance companies. It may thwart enterprise wide uniformity in compliance procedures. Several aspects of the rule are mechanically unworkable. Accelerated approval and effectiveness conflict with the SEC's statutory obligation to assure that SRO initiatives do not impose unwarranted anticompetitive consequences.

- The NASD has failed to provide an economic impact statement. SRO rule changes need careful evaluations of economic burdens to properly balance them against the regulatory goals of the initiative. The SEC cannot effectively execute its statutory responsibility without the means to conduct a regulatory balancing.

- The NASD has not quantified the scope of the regulatory problem it seeks to solve in the rule proposal. Instead, the NASD offers general observations without any statistical or numerical validation. Good rulemaking demands more.

- An impressive number of state and federal initiatives are underway that address the supervision, suitability, and disclosure about variable annuities. For example, the NASD recently conducted an annuity roundtable that will have a number of task forces on these matters that will promulgate recommendations. ACLI participated in the NASD roundtable and has a proactive CEO Task Force on Annuities that developed a comprehensive initiative on streamlined annuity disclosure and meaningful suitability procedures. State regulators are also actively developing initiatives to address similar matters. With so many moving parts, it is premature to accelerate the rule's approval and effectiveness.

Competitive and Economic Impact

The NASD's proposal contains no competitive or economic impact statement, and does not quantify the burdens on broker-dealers or variable product manufacturers under the proposed changes. The proposal may impose substantial competitive burdens on the variable annuity industry. These are important considerations for the SEC in reviewing and approving this specific NASD initiative.

When it amended the Exchange Act in 1975, Congress specifically charged the SEC with the responsibility to evaluate competitive burdens of SRO rules and rule changes. The Senate report on the legislation stated that:

> Sections 6(b)(8), 19(b) and 19(c) of the Exchange Act would obligate the Commission to review existing and proposed rules of the self-regulatory organizations and to abrogate any present rule, or to disapprove any proposed rule, having the effect of a competitive

> restraint it finds to be neither necessary nor appropriate in furtherance of a legitimate regulatory objective.[3]

Section 23(a) of the Exchange Act was also added in 1975, and requires the SEC to consider the anti-competitive effects of rule changes, and to balance any impact against the regulatory benefit to be obtained.[4] Similarly, Sections 15A(b)(6) and (9) of the 1934 Act require the SEC to evaluate carefully the competitive impact of proposed SRO rules and amendments.

The Securities Act Amendments of 1975 significantly expanded the SEC's oversight and regulatory powers concerning SRO rules, and specifically directed the SEC to carefully evaluate competitive factors in exercising its SRO oversight. Importantly, Congress did not intend to confer general antitrust immunity on SRO rulemaking that was subject to the SEC's oversight review.[5] Congress did not intend the SEC to delegate or abdicate to the NASD this important protection against anticompetitive conduct.[6]

The antitrust immunity created by Congress contemplates active oversight by the SEC in executing its responsibilities to ensure consistency with the securities laws, and to blunt the anticompetitive behavior inherent in self-regulatory conduct. Otherwise, a Congressional grant of substantial regulatory authority to private organizations without federal regulatory oversight would violate the constitutional prohibition against the delegation of legislative powers.

In order for SEC review to provide immunity for self-regulatory conduct, the review must be active, and must result in a ruling by the SEC that is judicially reviewable.[7] Section 25 of the 1934 Act states that the SEC's actual findings are conclusive if supported by substantial *evidence*, and that its decisions should be overturned only if "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law, the excess of statutory jurisdiction, authority, or limitations, or short of statutory right, or without observance of procedures required by law." The proposed rule amendments fail the statutory safeguards to competition set forth above.[8]

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[3] S. Rep. 94, 94th Cong., 1st Sess. (April 14, 1975) at 12.

[4] *Id*. at 12.

[5] *See*, Smythe, *Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation*, 62 N.C. L. Rev. 475 (1984) at 504 [the SEC has an obligation in reviewing SRO conduct to "weigh the competitive impact in reaching regulatory conclusions"].

[6] A number of studies have identified and criticized patterns of anticompetitive SRO conduct. *See* Securities Markets: Competition and Multiple Regulators Heighten Concerns about Self-Regulation (03-MAY-02, GAO-02-362); Securities Markets: Opportunities Exist to Enhance Investor Confidence and Improve Listing Program Oversight (08-APR-04, GAO-04-75); Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure (06-OCT-04, GAO-05-61).

[7] *Id.*

[8] In a different context, former SEC Chairman Levitt emphasized the importance of reviewing the impact of rulemaking on competition when he stated:

> In response to the National Securities Markets Improvement Act of 1996 (NSMIA), the Commission has rededicated itself to considering how rules affect competition, efficiency, and capital formation as part of its public interest determination. Accordingly, the Commission intends to focus increased attention on these issues when it considers

The NASD's rule request for SRO rule approval does not fulfill the important SEC and statutory goals to protect both competition and investors. *NASD Amendment No. 2 simply states that "NASD does not believe that the proposed rule will result in any burden on competition that is not necessary or appropriate" without any analysis or substantiation.* The SEC cannot execute its explicit statutory burden to prevent anticompetitive SRO rules under these circumstances.

The SEC should not advance the proposed rule in any manner without a full NASD analysis and justification of rules' anticompetitive impact. If the proposed single-product suitability rule advances, it will be incumbent on the NASD promptly to adopt multiple single-product suitability and supervision rules for securities incurring a greater incidence of disciplinary actions and complaints.[9] Otherwise, the NASD would be targeting one of many financial products in a discriminatory, burdensome fashion without firm rationale.

Conclusion

For these reasons, we respectfully request that the Commission expressly deny NASD's request for accelerated approval and effectiveness of Rule 2821. The SEC should provide an extensive comment period and allow robust evaluation of the significant modifications in Amendment No. 2.

An extensive comment period will not unduly lengthen this regulatory matter, and will foster constructive, thoughtful input on the issues raised in the release. The regulatory process and the public interest will be better served by a deliberative, not rushed, review of the NASD's rule amendments. These regulatory modifications are too important to miss full exposure to public scrutiny.

We greatly appreciate your attention to our concerns. If any questions develop, please call.

Sincerely,

Carl B. Wilkerson

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rulemaking initiatives. In addition, the Commission measures the benefits of proposed rules against possible anti-competitive effects, as required by the Exchange Act.

See testimony of Arthur Levitt, SEC Chairman , concerning appropriations for fiscal year 1998 before the Subcommitte on Commerce, Justice, and State, the Judiciary, and Related Agencies of the House Committee on Appropriations (Mar 14, 1997), which appears at http://www.sec.gov/news/testimony/testarchive/1997/tsty0497.txt

[9] As a point of reference, the NASD has published suitability and supervision concerns about various other securities, such as collateralized mortgage obligations, funds of hedge funds, non-conventional investments, mutual funds, and direct participation programs, without creating free standing suitability or supervision rules. *See* Notice to Members 93-73 [Members Obligations When Selling Collateralized Mortgage Obligations]; NASD Investor Alert-*Funds of Hedge Funds: Higher Costs and Risks for Higher Potential Return* (Aug. 23, 2003); Notice to Members 03-07[Non-Conventional Investments]; Notice to Members 94-16 [NASD Reminds Members of Mutual Fund Sales Practice Obligations (on break points and switching]; Notice to members 95-80 [NASD Further Explains Members Obligations and Responsibilities Regarding Mutual fund Sales Practices]; Notice to Members 91-69[Secondary Market in Direct Participation Programs]. To address break point abuses in mutual fund sales, the NASD issued IM-2830-1, not new suitability and supervision rules.

CBW/pm

cc: The Honorable Christopher Cox, Chairman
The Honorable Cynthia Glassman, Commissioner
The Honorable Paul S. Adkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Annette L. Nazareth, Commissioner