



August 6, 2004

Ms. Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Via Electronic Mail: pubcom@nasd.com

**Re: Proposed Rule Governing the Purchase, Sale
or Exchange of Deferred Variable Annuities**

Dear Ms. Sweeney:

The National Association of Insurance and Financial Advisors (“NAIFA”) and the Association for Advanced Life Underwriting (“AALU”) submit this letter in response to NASD’s request for comments on the Proposed Rule Governing the Purchase, Sale, or Exchange of Deferred Variable Annuities (NASD Notice To Members 04-45)(the “Proposed Rule”).

NAIFA is a national federation of over 700 state and local associations, whose members live and work in every congressional and state legislative district. The 65,000 members of these associations are bound by NAIFA’s Code of Ethics and are full time professionals in insurance and related financial services. Founded in 1890, NAIFA is the nation’s oldest and largest trade association of insurance and financial services professionals. NAIFA’s mission is to enhance the professional skills and promote the ethical conduct of agents and others engaged in insurance and related financial services that assist the public in achieving financial security and independence, and to improve the business environment. A Majority of NAIFA members are licensed as registered representatives of broker-dealers and market and service variable annuities, mutual funds and other investment products.

AALU is a nationwide organization of life insurance agents, many of whom are engaged in complex areas of life insurance such as business continuation planning, estate planning, retirement planning, deferred compensation and employee benefit planning. AALU represents approximately 2,000 life and health insurance agents and financial advisors nationwide.

In the past several years, NASD has issued a number of alerts and notices to educate investors and broker-dealers engaged in transactions involving variable annuities. The proposed rule is based on a “Notice to Members” issued by NASD in 1999 (NtM 99-35). NtM 99-35 provided “best practices” guidance to assist broker-dealers in developing procedures relating to the purchase, sale or exchange of deferred variable annuities.

As the Proposed Rule is currently drafted, NAIFA members who are registered representatives of broker/dealers affiliated with life insurers and who sell variable annuities will be required to comply with the requirements of the rule when it becomes effective. The provisions that most directly affect registered representatives are the suitability and disclosure requirements. Compliance with the Proposed Rule’s approval, supervision and training requirements is not the direct responsibility of registered representatives. Having said that, however, those requirements are ultimately intended to force broker-dealers to work with their sales forces to ensure they are knowledgeable and well supervised, and that transactions are well scrutinized.

The elements of the Proposed Rule are straightforward and address three areas: suitability of transactions, disclosure of transactions, and approval of transactions by a registered principal. In addition, broker-dealers would be responsible for establishing supervisory procedures to guide compliance with these requirements and training for registered representatives who sell deferred variable annuities.

More specifically, the Proposed Rule would impose specific suitability requirements in connection with the sale of deferred variable annuities, as well as require registered representatives and others marketing variable annuities to present their variable annuity customers with a “risk disclosure document” separate and apart from the variable annuity prospectus. The new disclosure document would highlight only the risks and expenses of variable annuities, and would be required to include surrender charges and potential IRS penalties, sales charges, fees and expenses, and a discussion of the federal tax treatment and market risk of variable annuities. The document would not contain any discussion of the beneficial aspects of variable annuities.

NAIFA and AALU firmly believe that people who engage in unscrupulous or misleading sales practices should be aggressively prosecuted and subject to appropriate and meaningful sanctions. We are forced, however, to oppose promulgation of the Proposed Rule for three reasons:

- The Proposed Rule’s suitability and disclosure requirements are redundant and would duplicate requirements already in force;
- The Proposed Rule would place the variable annuities industry at a competitive disadvantage by imposing requirements on variable annuities that are not imposed on comparable investment products; and
- Available statistics indicate that variable annuities transactions make up a small percentage of total disciplinary actions undertaken by NASD.

1. The Proposed Rule's suitability and disclosure requirements are redundant and would duplicate requirements already in force.

The Proposed Rule would duplicate suitability and disclosure requirements with which broker-dealers and registered representatives are currently required to comply. Adopting a separate rule specifically applicable to variable annuities is therefore unnecessary and would be redundant. This redundancy would do little to protect consumers and, in fact, could cause confusion and misunderstanding, ultimately leading to less effective consumer protection. If regulators believe there are abusive practices in the variable annuities marketplace, appropriate enforcement of existing laws and the current NASD suitability rule is the solution, as opposed to adoption of a new rule.

Suitability

The Proposed Rule's suitability provision requires a registered representative to solicit information from a customer and analyze that information to determine if investment in the deferred variable annuity is appropriate for the customer.

Suitability requirements are not new in securities transactions, including the sale of variable annuities. The federal securities laws and rules of the self-regulatory organizations (SROs) currently include provisions that, directly or indirectly, give rise to suitability obligations. In addition, NASD has issued specific rules requiring broker-dealers to determine if a security is suitable for a customer in light of the customer's age, financial situation, risk tolerance, and investment objectives (NASD Rule 2310 and NASD Conduct Rule IM 12310-2). NASD has issued guidance stating specifically that these suitability rules apply to transactions involving variable annuities (NtM 96-86, 99-35 and 00-44). Again, appropriate enforcement of existing suitability requirements rather than the adoption of a new rule is the proper solution to any problems that may exist.

Disclosure

The Proposed Rule's disclosure provisions require a registered representative to provide a customer with the current prospectus of the deferred variable annuity and a separate "risk disclosure document." For registered representatives, a critical element of the disclosure document is the requirement that it include information regarding sales charges, administrative fees and investment advisory fees.

NAIFA and AALU understand the NASD's concern about the adequacy of disclosure. Proper disclosure of expenses and fees is currently a significant regulatory issue, in large part in response to the mutual fund conflict of interest scandals. Like the suitability requirement, however, the Proposed Rule's requirement that a separate disclosure statement be delivered to the investor would duplicate requirements already in place regarding the contents and delivery of a variable annuity's prospectus. Variable annuity prospectuses, which are reviewed by the Securities and Exchange Commission (SEC), already discuss the fees, risks and expenses associated with the product. In addition, earlier this year, the SEC issued three proposed rules addressing the fee disclosure issue. Requiring a separate, duplicative document would run

counter to the efforts of the SEC over the past decade to simplify the contents of prospectuses. Instead, the NASD should focus its efforts on getting consumers to carefully read the prospectus they already receive.

2. The Proposed Rule would impose requirements on variable annuities that are not imposed on comparable investment products.

The Proposed Rule would impose new suitability and disclosure requirements on the sale of variable annuities, but not on comparable investment products such as mutual funds and real estate limited partnerships. These additional burdens would place broker-dealers, registered representatives and financial institutions that sell variable annuities at a competitive disadvantage in comparison with those who market other types of investments. The additional requirements, while adding little if anything in terms of consumer protection, could ultimately cause expenses and, therefore, the fees associated with variable annuities, to rise. Higher costs will cause consumers to look to other, less expensive investment products. To the extent the other products are favored and have lower compliance costs, they will be less expensive and, thus, be at a competitive advantage as compared to variable annuities.

There does not seem to be any logic to this differential treatment. Currently suitability and disclosure rules apply to variable annuities as well as other investment products. Singling out variable annuities for additional regulation to the exclusion of other investment products is either over-kill or under-protection. If the NASD sees a need to adopt additional rules for variable annuities, logic would dictate that it also adopt additional rules for other, comparable investment products.

3. Despite alleged abuses, statistics indicate that variable annuities make up a small percentage of total disciplinary actions undertaken by NASD.

Finally, NAIFA and AALU believe that the NASD proposal is a “solution in search of a problem.” The available data simply does not support the NASD’s claims that the number of sales and marketing abuses in the variable annuity marketplace warrants adoption of specific suitability and disclosure rules governing variable annuity sales. In recent years, NASD disciplinary actions relating to variable annuities and people who sell variable annuities have constituted roughly 8% of the NASD’s total annual disciplinary actions. This is despite the fact that registered representatives working for broker-dealers affiliated with life insurers – that is to say, variable products salespeople – comprise over 50% of the total number of registered representatives.

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In conclusion, NAIFA and AALU firmly believe that people who engage in misleading sales practices should be aggressively prosecuted and subject to meaningful sanctions. Having said that, we note that the NASD already has the requirements in place and the tools available to ensure appropriate and suitable variable annuity products are sold to consumers, and thorough and comprehensive disclosures are made available to customers. The Proposed Rule would unnecessarily duplicate the current requirements and place variable annuity products, and the

individuals who sell them, at a disadvantage to other, comparable investment products and their salespeople. If regulators really want to protect consumers, NAIFA and AALU believe the fairest, most effective way to do so is through appropriate enforcement of existing rules and through concerted efforts to encourage consumers to carefully read the information currently found in prospectuses.

Thank you for your consideration of our views. Please contact us if you have any questions regarding our comments.

Yours Truly,

/s/ Gary A. Sanders

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