

Via email and regular mail

August 9, 2004

Ms. Barbara Z. Sweeney  
National Association of Securities Dealers  
Office of the Corporate Secretary  
1735 K Street, N.W.  
Washington, DC 20006-1500

RE: Comment on Proposed Rule Governing the Purchase, Sale or Exchange of  
Deferred Variable Annuities

Dear Ms. Sweeney:

Thank you for the opportunity to comment on the above-referenced rule proposal more fully described in the NASD's Notice to Members 04-45, published on June 9, 2004.

Commonwealth Financial Network ("Commonwealth") fully supports the NASD's efforts to ensure suitable recommendations and adequate supervision of transactions in deferred variable annuities, and its efforts to enhance investor education and protection. Commonwealth is committed to providing investors with the information they need in order to make informed investment decisions, including a complete picture of the costs, features and risks of any investment. However, we are concerned that the proposed variable annuity rule will not achieve its intended purpose and instead will create confusion among broker-dealers, insurance companies and those who regulate the sales of variable annuities. The rule as proposed would impose significant new burdens on broker-dealers, putting them in an untenable position between the issuers of variable annuities and investor. In particular, the proposed disclosure documents would in all likelihood have to be filed and approved by state insurance regulators. A task that could take years. Moreover, we are concerned that proposed rule breaks new ground regarding unsolicited transactions.

The proposing release raises several issues:

#### CUSTOMIZED POINT OF SALE DISCLOSURE DOCUMENTS

- The costs related to each member firm developing, maintaining and updating its own disclosure brochures for each issuer's variable annuity products are significant. Commonwealth is an independent broker-dealer and currently maintains selling agreements with approximately 30 variable annuity product

sponsors, with an average of 4 products per selling agreement and a rider selection of 3 to 5 choices per product (combining living and death benefits). Based on this information alone, it becomes clear that the number of specific investment scenarios to describe in a customized point of sale brochure becomes extraordinarily large and burdensome.

- State specific variations in each contract will also have to be addressed, increasing the number and complexity of the task of creating and maintaining these supplemental disclosure documents.
- Requiring each member firm to create their own customized point of sale brochures will shift the burden and cost of creating disclosure documents from the issuing insurance companies to the broker-dealers selling their products.
- Individual selling firm-created disclosures create the potential for significant differences in the content of the disclosures between selling firms, potentially leading to client confusion and complicating a client's ability to make meaningful comparisons between products being offered by different firms. Each firm will exercise its own judgment regarding the significance of the various product features, which in turn creates the potential for unbalanced disclosure.
- It is not clear how customized point of sale disclosure documents would fit within the existing federal securities laws relating to disclosure. Is the brochure sales material? An omitting prospectus? How do state insurance laws governing product related materials apply? It appears that the proposed disclosure documents would have to be filed and approved by state Departments of Insurance. Are they prepared to handle the volume of materials that will be generated in an effort to comply with these proposed requirements?

In an effort to address the disclosure concerns noted by the NASD in proposing the rule, Commonwealth supports efforts to provide investors with meaningful and clear disclosure information. However, requiring new types of disclosure is unnecessarily duplicative of existing regulations on firms distributing variable annuities. We believe that the NASD's goals can be met by the SEC requiring better plain-English disclosure language prepared by the product issuers and incorporated into the product's prospectus and supplemental sales material. Finally, the proposed disclosure requirements appear duplicative of those proposed by the SEC in its Confirmation and Point of Sale rule. Any additional disclosure requirements should be withheld until the SEC rule is finalized.

#### APPROPRIATENESS/SUITABILITY

- Several existing rules, regulations and interpretations, such as NASD Rules 2110, 2210, IM-2210-2, Rules 2310, 3010, 3110 and NTM 99-35 adequately address the issue of suitability in the sale of variable annuities. In addition, as insurance products, variable annuities are also subject to state law insurance regulations. The solution to preventing sales practices abuses is not additional rules and

regulations, but enforcement of the more than adequate existing rules and regulations.

- We believe that the imposition of suitability obligations for unsolicited sales of variable annuities is unwarranted. Existing NASD rules do not require member broker-dealers to make suitability determinations for unsolicited transactions in other products. To require a suitability review of unsolicited variable annuity sales is inconsistent with the NASD's often stated position that a broker-dealer's responsibility with regard to unsolicited transactions is generally limited.
- Variable annuity insurance features require broker-dealers to expand the scope of its suitability analysis beyond traditional investment considerations to include things such as a client's tax and estate planning, and insurance needs. There can be a legitimate and suitable basis for a registered representative to recommend that a client purchase a variable annuity within a tax-qualified account. Considerations such as a client's potential need or desire for a lifetime income stream, death benefits, earnings enhancement benefits, asset protection from creditors, cost-free annuitization and certain other guarantees available within some variable annuity contracts can provide a legitimate basis for such recommendations.

## REPLACEMENTS

- Commonwealth supports the NASD's efforts to ensure that any recommendations to exchange or replace existing variable annuity investments are suitable. However, a side-by-side comparison of old and new contracts is not always possible in situations where the representative did not sell or does not have access to detailed information about the old contract. Moreover, under existing rules and regulations registered representatives already have a clear requirement to have a reasonable basis for their recommendations.

While we believe existing rules are sufficient to cover replacements, if this section is not deleted from the new rule it should be amended to allow for a summary of the reasons for recommending the replacement, as well as including a provision to allow for the client's certification that the old contract information is not available, and in such cases a side-by-side comparison would not be required.

## PRINCIPAL REVIEW

- The proposed rule requires that a principal review and approve a variable annuity application within one day of a client signing the application. For an independent broker-dealer, this would be a virtual impossibility to accomplish. Many registered representatives and clients are located in remote locations from the home office where business is processed. This is important because many variable annuity applications are still completed in paper form. In many cases, especially in those locations where it is difficult to access overnight mail service, it would

create logistical and administrative nightmares to submit applications to the home office or OSJ for review and approval within 24 hours. Unexpected high volume of transactions or unexpected absences of operations and administrative staff would create additional hurdles. Additionally, the 24 hour turn around does not provide adequate time for the reviewing principal to obtain and review additional data from the representative or client to complete a review of a proposed transaction. Requiring such a short turn around may in fact hurt the existing review process as the principal may be faced with sacrificing additional review and due diligence to meet this artificially created 24 hour deadline.

- NASD Rule 2820(d), as written requires members to transmit applications for variable contracts “promptly to the issuer.” We believe the proposed rule should be amended using the promptly timeframe to be consistent with 2820(d).
- In addition, state insurance laws provide consumers with a “free look” period that does not begin until the consumer receives the annuity contract. During this period the consumer can decide to cancel the contract, an option that does not exist without other securities.

## TRAINING

- While we agree that there is a need for adequate training of registered representatives and principals with regard to the sale of variable annuities, the proposed requirements go beyond requirements for transactions in other securities that are much riskier investments, such as uncovered options, “penny stocks,” short selling, or margin calls. To require that firms establish additional training policies and programs beyond those that may be part of the Continuing Education Program is unnecessarily burdensome. The current registered representative and principal examination requirements include variable products. Moreover, registered representatives selling variable products have insurance licenses and have thus completed additional training in insurance products beyond their NASD examinations.

In general, several features of the proposed rule echo existing requirements. Member firms are already required to develop and maintain supervisory procedures appropriate to its business. Each firm is required to address the training needs of its field force and supervisory staff under the Firm Element Continuing education requirements. In light of these existing requirements, we do not believe that variable annuity-specific requirements are necessary.

In response to the NASD’s specific questions posed in NTM 04-45, we offer the following comments:

1. *Should the NASD's rule be modeled after the "best practices" guidelines discussed in NTM 99-35, the proposed approach, or an alternate approach such as prescribing the types of investors to whom variable annuities can be sold?*  
**Comment:** We believe that the final rule should be modeled after the best practices guidelines that provide for flexibility and well-defined standards that can be consistently applied. The NASD should not prescribe the types of investors to whom variable annuities can be sold. Such an approach is contrary to the basic principles upon which our free markets are founded.
2. *Should the proposed rule cover all variable annuity transactions, and not just deferred variable annuities?*  
**Comment:** No. Additional regulations are only appropriate when there are significant compliance or customer protection issues that must clearly be addressed.
3. *Should the risk disclosure document focus on information applicable to all deferred variable annuities offered by the firm rather than product specific disclosures? Can investors be educated in other ways?*  
**Comment:** As discussed above, we believe that product specific disclosure brochures created by broker-dealers is not appropriate. A more general disclosure brochure that addresses key areas related to costs, tax matters, liquidity and other related issues may be effective in ensuring that the customer has a full appreciation of the features, benefits and risks of the proposed investment. Many firms, including Commonwealth, already employ the use of such general disclosures to assist both the representative and client in the sales process. The NASD's current investor education efforts (enhanced web site, Investor Alerts and town meetings, etc.) have brought investor education to a new level. We believe these efforts, including opportunities to link informational resources to member firm web sites, should continue. Investor education can also be supported by enhancing product issuer sales and disclosure materials, including the enhancement of the plain-English product prospectus.
4. *How would the NASD's rule interplay with the SEC's proposed point-of-sale disclosure rule?*  
**Comment:** We believe that the NASD should defer action on its proposal until the SEC efforts have been finalized.
5. *The NASD is considering bright-line metrics for the suitability screening prescribed by the proposed rule. What metrics should be considered the standard for age, net worth, absolute value, investment horizon, sophistication, etc.?*  
**Comment:** While general guidelines may be helpful to member broker-dealers in establishing their own internal policies, any standard industry metrics should be considered guidelines, rather than absolute limits. Commonwealth's internal guidelines provide its principals with a tool to assist in the first level of review of transactions, but also provide significant flexibility to enable the principal to

exercise his or her own judgment in evaluating the specifics of a particular transaction.

Commonwealth appreciates the opportunity to provide comments on the proposed deferred variable annuity proposal. We hope these comments will prove useful in your review of the proposed rule. We welcome any questions you may have and would be pleased to discuss our views with you at any time. Please feel free to call me directly at 781-736-0700 ext.9904.

Sincerely,

Peter T. Wheeler  
President