



NASAA

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August 24, 2004

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

Via e-mail to pubcom@nasd.com

RE: Proposed Rule Governing the Purchase, Sale, or Exchange of Deferred Variable Annuities; NtM 04-45

Dear Ms. Sweeney:

This letter is submitted by the North American Securities Administrators, Inc. (NASAA) in response to the NASD request for comments regarding the above-referenced proposed rule. NASAA believes that many of the practices curtailed by the rule should already have been incorporated as part of firms' compliance programs. Thus, we appreciate the opportunity to comment on certain aspects of the proposed rule, as detailed below.

A. The Proposed Rule Should Cover All Variable Annuity Transactions, Not Just Deferred Variable Annuity Transactions

The specific exclusion of immediate variable annuities from the requirements of the proposed rule raises serious questions about the standards an NASD member would adopt for the sale of immediate variable annuities.

The proposed rule is very specific about an NASD member's requirements regarding the sale of a deferred variable annuity. No conditions are specified for the sale of an immediate variable annuity. There is not even a discussion in the proposal of conditions that would apply. A member must have the same reasonable basis of fact in recommending this type of variable annuity. The customer has the same legal right to be informed of the costs and risks associated with the purchase of an immediate variable annuity. We believe that NASD members have the same legal responsibilities of principal review, documentation and supervisory requirements as specified in Rules 3010 and 3110 for an immediate variable annuity. Because NASAA's view is that the requirements and legal responsibilities surrounding immediate and deferred variable annuity transactions are equivalent, the proposed rule should expressly include provisions governing all variable annuity transactions.

B. Disclosure and Prospectus Delivery

Section (b)(1)(B) of the Proposed Rule outlines a requirement for a “Separate, brief and easy-to-read (written in “plain English”) risk disclosure document” A member or person associated with the member would be required to provide this document to the client prior to effecting any sale.

NASAA agrees with NASD that plain-English disclosure of variable annuities is of utmost importance and supports the requirements set forth in this provision.

C. The Risk Disclosure Provision Should Include a Combination of Both Product-specific and General Information

Because variable annuities are indeed complex investment products and there has been a high rate of customer complaints indicating that investors did not understand the features of variable annuities, NASAA supports the provision that a separate risk disclosure document should be provided in addition to the prospectus. A potential investor is more likely to read the brief and easy-to-read risk disclosure document compared to the prospectus; thus, a risk disclosure document that discloses specific and general information should be more beneficial to a potential investor.

The purpose of a risk disclosure document is to inform prospective investors about the risks and facts that may have an adverse impact on their investments. Product specific information is essential because it helps potential investors understand the complicated features of each specific product such as market risks, fees, liquidity and taxes. General information about the risks and facts about the variable annuities being offered is just as important because such information allows reasonable investors to make informed decisions and determine whether such products are suitable investments. Among the general information included in the risk disclosure document should be: advantages and disadvantages of investing in variable annuities; other products that may be suitable for the investor; the distributors’ policies on combating excessive trading; and methods of pricing.

D. Principal Review Should Include a Periodic Review of the Associated Person’s Production Report for Variable Annuities

NASAA agrees with the NASD’s position that a principal should review and approve the variable annuity transaction, regardless of whether the transaction has been recommended. This review should be conducted in a thorough and timely manner, taking into account whether: (1) the customer's age or liquidity needs make a long-term investment suitable;; (2) the amount of money invested exceeds a stated percentage of the customer's net worth, or is more than a stated dollar amount; (3) the transaction involves an exchange or replacement of a variable annuity contract; (4) the customer's account has a particularly high rate of variable annuity exchanges or replacements; (5) the associated person effecting the transaction has a particularly high rate of effecting variable annuity exchanges or replacements; and (6) the purchase of the variable annuity is for a tax-qualified retirement account (e.g., a 401(k) plan, IRA).

In addition, NASAA believes that the registered principal should review the total sales and production of variable annuities of the associated person(s) to detect unsuitable sales or other potential abuses. An effective supervisory program should mandate that such review take place in a timely manner. This will permit the principal to detect possible patterns of sales practice violations that reviews on a sale-by sale basis may not reveal.

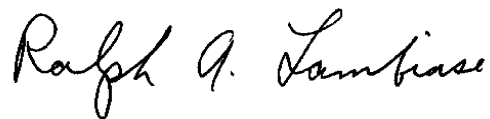
E. If Hypothetical Illustrations are Used, the Rule Should Require Illustrations That Are Not Misleading

NASAA believes that the proposed rule should include a provision that specifically addresses the use of hypothetical illustrations in variable annuity transactions. NASAA shares NASD's concern that some tax-deferral illustrations may rely upon incorrect or misleading assumptions. NASAA members have also experienced problems with agents improperly using general mutual fund illustrations instead of illustrations regarding specific variable annuity sub-accounts, i.e., using the net asset value (NAV) of the parallel retail mutual fund instead of the accumulation unit value (AUV) of the variable annuity sub-account in illustrating a hypothetical performance.

The problem arises because investments through a variable annuity sub-account and through the retail mutual fund, are not the same. Consequently, customers are likely to be misled about, among other things, the expenses associated with the variable annuity and the sub-account(s). The proposed rule should require member firms to review on an ongoing basis marketing communications that use hypothetical illustrations. Even absent a specific rule, firm training policies and programs should ensure that hypothetical illustrations fully and fairly disclose all of the material features of variable annuities and sub-accounts.

Thank you for your consideration of NASAA's views on these issues. If you have any questions regarding the comments contained in this letter, please do not hesitate to contact Tanya Solov, Director of the Illinois Securities Department and Chair of NASAA's Broker-Dealer Section, or James Nelson, Office of the Mississippi Secretary of State and Chair of the Broker-Dealer Variable Annuities Project Group.

Sincerely,

A handwritten signature in black ink that reads "Ralph A. Lambiase". The signature is written in a cursive, flowing style.

Ralph A. Lambiase
NASAA President and
Director, Connecticut Division of Securities