

August 3, 2004

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

Dear Barbara Sweeney:

This letter is in reference to the proposed rule in NTM 04-45.

1. As Proposed, Point-of-Sale Risk Disclosure Brochures - The concept of each broker-dealer creating, maintaining, and updating its own versions of risk disclosure brochures for each variable annuity product would be extraordinarily expensive, administratively impractical, and risky for broker-dealers. The insurance companies should put out generic point of sale disclosure brochures.
2. Suitability Obligations for Unsolicited Sales - The proposed rule's distinctions between the suitability analysis for recommended versus unsolicited transactions is confusing and ambiguous. The distinction appears to be that for recommended transactions the front-line associated person must make an initial suitability determination, but for unsolicited transactions the suitability determination must be made by the reviewing principal – in either case suitability must be determined before the transaction is concluded. In recommended transactions, the designated principal is required to consider “underlying supporting documentation” but apparently that is not required in the case of unsolicited orders. The rule's text can be read to treat documenting the suitability analysis differently.

Creation of a new suitability standard for unsolicited orders of variable annuities is inappropriate and is inapposite of the legal requirements relating to suitability issues that have developed over the past several decades. In addition, this new, largely artificial distinction may lead to unwarranted calls for the same requirement to be applied to other complex financial products.

3. Suitability Determination Must Include Insurance and Securities Considerations - The NASD acknowledges that a variable annuity contains both an insurance component and a securities component. The

proposed rule appears to give little or no weight to the insurance features of a variable annuity in the suitability analysis. The insurance features or a variable annuity are critical, however, and often times are a compelling reason for investors to purchase a variable annuity and, we would suggest, must be considered by any representative in determining whether a particular annuity is suitable for a customer.

4. Variable Annuities in Tax-Qualified Retirement Plans are not Unsuitable Per Se - The proposed rule suggests that variable annuities in tax-qualified retirement plans are automatically unsuitable. We would suggest that this implication is unwarranted. A variable annuity may have additional features that attract investors with a qualified retirement plan assets. They are death benefit, annuitization options, and no transaction charges.
5. Involvement of Multiple Associated Persons and/or Principals in Sales Process - The rule requires the sign-off of the associated person recommending the variable annuity and “a” principal reviewing the application. In some transactions, multiple associated persons may be involved in recommending a variable annuity to a customer – perhaps from different offices and/or at different times. For example, one associated person may present a seminar to a group of prospective investors on a product, a second associated person may provide additional information to a prospective investor, and a third associated person may take and accept the completed application. These associated persons may have different supervisors. The proposed rule does not contemplate nor give guidance about these common scenarios.
6. Customer Information Required Should be Uniform - A different standard for variable products will be more difficult and confusing for representatives, and more expensive for firms. Uniform standards for all products (as is the current practice) are more meaningful for an effective suitability review. All required customer data gathering should be prescribed in one section of the NASD rules to avoid inadvertent omissions.
7. Comparison of Old and Replacement Policies - A customer may not have retained a copy of the old policy or an associated person may not have access to it. The issuer of the old policy may be uncooperative in furnishing a copy if it knows the customer is considering replacing the old product. Must the firm decline to do business with that customer because the required comparison cannot be made? The rule should allow for a customer’s certification that the old policy is unavailable. There are instances when, because of competition driving policy enhancements in the variable product market place, an old policy can be readily determined to be outdated or no longer designed to serve the needs or best interests of the client because of new features that are available without the need for extensive analysis.

8. One Business Day Turn Around - This artificially short turn-around time is unnecessary and administratively unworkable. In many small firms, a designated principal may not be available on such short notice due to other firm responsibilities. In many instances, principals reviewing transactions will request additional information before granting approval, and the information cannot be compiled in one day, often times through no fault of the firm. Rather, the customer typically is unable to provide the additional information that is requested. Today, representatives in satellite offices often send completed applications to the home office by mail. The proposed rule would require faxes or overnight delivery services, adding to the cost of the transaction and placing unwarranted time pressure on supervisors. If one of the purposes of the supervisory review is to verify the suitability of the product, we would respectfully suggest that the supervisor should be afforded a reasonable period of time in which to conduct that review.
9. Standards for Principal Review - The proposed rule references “red flag” standards that are to be set by the firm, but offers no guidance or benchmarks to assist a firm in developing those standards. For example, what customer age does the NASD find troublesome? What percentage of net worth? What absolute dollar figure? What is a “long term” investment objective in the context of annuities? By requiring principals to consider these factors but not giving any guidance on what the NASD would consider unsuitable, the NASD is not giving firms adequate tools to comply with the rule. The NASD could compile this data from its enforcement proceedings, build a consensus with input from the industry and academia, and publish the results. These published benchmarks could be offered in the form of rebuttable presumptions that could be outweighed by the specific needs and circumstances of the customer.

Sincerely,

Richard Baughman