



August 19, 2004

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

Re: Proposed rule governing the purchase, sale, or exchange of deferred variable annuities—NTM 04-45

Dear Ms. Sweeney:

Securities America, Inc. ("SAI") appreciates the opportunity to comment on the above-captioned matter. SAI shares many of the NASD's concerns with respect to some members' unsuitable recommendations and inadequate supervision of transactions in deferred variable annuities ("VAs"). These concerns have been reported in the numerous recent enforcement actions taken against various members by the NASD and SEC.

While SAI agrees with the NASD that steps should be taken to better ensure that VAs are sold in a suitable manner, SAI offers the following discussion points and some alternatives for consideration by the NASD that may more effectively achieve the NASD's objectives.

General Comments

SAI understands that VAs are complex financial instruments and we support the NASD's efforts to enhance investor education and protection. We applaud the NASD and SEC for creating numerous educational pieces regarding variable insurance products¹. We believe that these materials are excellent resources for investors to review when contemplating a variable annuity transaction, and we will share additional thoughts on other applications for this type of educational material in the recommendations section of this letter.

While VAs are complex, they also offer investors unique features not found in other products. Key among these features is annuitization which allows investors to receive a stream of payments for life. This feature can be especially valuable for retirees who are concerned about the possibility of outliving their assets. There are many other valuable

¹ Variable Annuities and Variable Life Products: Questions to Ask; <http://www.sec.gov/investor/pubs/varaquestions.htm>; Variable Annuities: What You Should Know; <http://www.sec.gov/investor/pubs/varannuity.htm>; NASD Investor Alert, Beyond the Hard Sell; http://www.nasd.com/investor/alerts/alert_variable_annuities.htm; NASD Investor Alert, Should You Exchange Your Variable Annuity? http://www.nasd.com/investor/alerts/alert_annuityexchanges.htm; NASD Investor Alert, Should You Exchange Your Life Insurance Policy? http://www.nasd.com/investor/alerts/alert_exchange_lifeinsurance.htm; NASD, Equity Indexed Annuities – A Complex Choice; http://www.nasd.com/investor/alerts/indexed_annuities.htm; NASD, Investing in a 401(k) – an Investment Menu; http://www.nasd.com/investor/Smart401k/investing_401k/invt_11.html; NASD Investor Alert, Betting the Ranch: Risking Your Home to Buy Securities http://www.nasd.com/investor/alerts/alert_betting_ranch.htm

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features such as tax-deferral, death benefits, and the ability to pass assets directly to a beneficiary at death to name a few.

Furthermore, competition among issuers of variable annuities has resulted in significant product enhancements over the years. Cynthia A. Glassman, of the U.S. Securities and Exchange Commission in a recent speech stated, "Competition has had a positive impact on the annuity industry in terms of fostering innovation in product development. Variable annuity products have changed rapidly over recent years in response to competitive pressures and client demands. As a result, the products can now include a wide array of features that were not available only a few years ago. These innovations are driven by the market, and if sold appropriately can help meet investors' financial planning needs."² Although Ms. Glassman notes that competitive pressures can also result in additional potentially unfavorable effects, SAI believes that the net effect to consumers is positive.

Specific Concerns with the Proposed Rule and Related Commentary

The commentary in NTM 04-45 states that VA sales "have been the subject of more than 80 NASD disciplinary actions in the past two years" involving a variety of misconduct including "excessive switching, misleading marketing, failure to disclose material facts, unsuitable sales, inadequate training and supervision of salespeople, and deficient written supervisory procedures."³ These are no doubt serious issues and SAI agrees with the NASD that reform will benefit the investing public.⁴ However, while the NASD contemplates implementing the Proposed Rules, we urge you to consider the following specific comments:

1) Proposed Risk Disclosure Document. Our primary concern with the Proposed Rule is the requirement for broker-dealers to disseminate the proposed risk disclosure document in addition to the prospectus at or before the point of sale. While we recognize the importance of full and fair disclosure, we are particularly concerned with this proposed requirement due to the logistical hurdles that would be created for broker-dealers.

SAI, like many other broker-dealers, has selling agreements with dozens of variable annuity issuers. The issuers generally have several different policies, and each policy often has several state variations. To comply with the Proposed Rule, SAI would be required to create or otherwise obtain hundreds of different product-specific risk disclosure documents and then keep these documents current as product changes occur.

² Speech by SEC Commissioner: Remarks before the National Association of Variable Annuities by Cynthia A. Glassman; Washington, D.C.; June 14, 2004; available at: <http://www.sec.gov/news/speech.shtml>

³ NASD Notice To Members 04-45; June 2004, pg 3.

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The Proposed Rule would require that the risk disclosure document highlight the "main features of the particular variable annuity transaction."⁴ Although the Proposed Rule prescribes some specific information to be included in the proposed risk disclosure document, the Proposed Rule appears to leave room for subjective determinations on what additional information, if any, would be considered "main features." Thus, another logistical hurdle for broker-dealers would be to ensure that information is presented uniformly from one product to another and from one insurance company to another.

We realize, of course, that the product issuers could prepare the product-specific risk disclosure documents. However, regardless of who prepares them—the broker-dealer or the issuing insurance company—there will no doubt be differences in the risk disclosure documents from broker-dealer to broker-dealer or from insurance company to insurance company.

What we could end up with is two "prospectuses"—one prepared by the issuing insurance company pursuant to SEC regulations and one prepared by the broker-dealer to comply with NASD requirements. This would seemingly cause customer confusion and increased expenses.

More importantly, this proposal will no doubt undermine the importance of the prospectus. The securities laws are based upon the premise that investors must be presented with the material facts relevant to a given transaction. The prospectus serves this purpose. Adding additional disclosure documents to the point of sale is no different than duplicating certain pages of the prospectus. Clearly no one would suggest that duplicating certain pages of the prospectus would be an effective way to highlight the content matter on those duplicated pages.

Finally, we should avoid punishing the sound and reputable sales activities of most representatives by creating rules based on the unscrupulous acts of the few. After all, we can expect those unscrupulous actors to ignore these rules anyway.

2) Variable Annuities in Tax-Qualified Plans are not Unsuitable Per Se. The rule proposed by the NASD suggests that selling variable annuities in tax-qualified retirement plans are presumed to be unsuitable. It is important to note, however, that tax advantage is not the sole and exclusive benefit that might attract the interest of a qualified plan participant. For example, some participants that are in need of life insurance benefits may lack the necessary funds outside of the retirement plan to obtain such coverage or are uninsurable due to health-related reasons. Buying an annuity inside of a retirement plan also allows pre-tax dollars to be used for the purchase, which could potentially allow the participant to obtain more benefits.

Legal experts have identified a variety of benefits of purchasing a variable annuity in a qualified plan, including family protection through the death benefits and guarantees that

⁴ NASD Notice To Members 04-45; June 2004, pg A2.

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the administrative fees charged will not increase during the life of the contract.⁵ These are some features that cannot be obtained by purchasing other securities. Additionally, the ability of the participant to secure a stream of income for life is a benefit that most defined contribution plans cannot offer. Although we concur with the general idea that the product should be suitable for the investor, we would caution against an rule that labels these products as unsuitable per se.

3) One Day Business Turn-Around for Principal Approval is Unneeded. The Proposed Rule requires that the principal's review, approval and suitability determination come within one day after the client has signed the application. This short turn-around requirement is unworkable and unnecessary for a variety of reasons. First, it may take a principal more than one business day to obtain additional information that may be deemed necessary. Due to other compliance priorities and work commitments, there is also a substantial risk that some principals may take the representative's recommendation at face value without conducting a complete analysis. As there are cases where a principal may want to see other information, it is clear that a longer and more flexible approval period would go far in helping to ensure that the principal's review is accomplished in a competent manner.

Additionally, the rule contemplates requiring a review of the original policy provisions when a principal approves a replacement transaction. Although a comparison of the original and replacement product is generally a good idea, there could be situations where the older policy has been lost or is otherwise unavailable. When facing a replacement situation, the issuer may also be uncooperative in providing a duplicate copy of the policy. This could also delay the principal approval process.

Furthermore, the insurance laws of most states require firms to provide clients with a "free look" period that begins whenever the client physically "receives" the policy. In view of the additional time the client is given to consider the transaction, it would appear that the compliance burdens of this rule would far outweigh the benefits to the client. Although we would concur that the principal's review should be conducted with reasonable promptness, a one-day turn-around is overly burdensome.

4) Standards for Principal Review are Unclear. The Proposed Rule references a number of "red flag" standards that are designed to guide a firm in determining whether an investment is suitable for the client. Although the six standards set forth in the proposed rule appear to be a good starting point in the analysis, specific safe harbor guidance is needed to help firms better determine what types of conduct are acceptable in most cases. For example, the first factor of the proposed rule suggests that a customer's age or liquidity needs could make an investment unsuitable. The Proposed Rule, however, fails to articulate what types of age and liquidity situations would cause the NASD to be concerned about suitability.

⁵ Tommy Thompson, *Non-Qualified Deferred Variable Annuities: A Product in Search of a Coherent Theory*, 493 79 N.D. L. Rev. 439, 492 (2003).

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The Proposed Rule also mentions that an investment exceeding either a stated dollar amount or a certain undefined percentage of the client's wealth could also render the investment unsuitable. As each client's gross wealth can vary considerably, a specific dollar limitation could have the undesirable effect of rendering an investment unsuitable for a high net-worth client, even when the investment is only a very small percentage of the client's overall wealth. Clear standards will better assist firms in educating representatives and their clients on the basis for suitable trades.

Responses to Specific Questions asked in NTM 04-45

The NASD asked several specific questions to be addressed by its members. SAI agrees with the comments made in the Financial Services Institute's Comment Letter filed with the NASD on or around July 23, 2004. A substantial portion of the responses below are taken from that letter.

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: The NASD's final rule should be modeled after the "best practices" guidelines. Applicable benchmarks ("red flags") should be defined and presented as rebuttable presumptions. Factors that warrant exceeding the benchmarks could also be identified. Flexibility is important, but well-defined standards will better assure consistency throughout the industry.

2) Should the proposed rule cover all variable annuity transactions, and not just "deferred variable annuities"?

Comment: No, in the absence of material compliance issues and customer complaints, the increased costs—which customers will ultimately bear—do not warrant extending the regulation to other products.

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 more effectively educated in other ways?

Comment: If after a careful analysis a separate risk disclosure document is deemed warranted, a product-specific brochure that must be created solely by broker-dealers is virtually unworkable for the reasons described above. Most of the desired customer education could be accomplished with generally applicable disclosures.

4) How would the NASD's rule interplay with the SEC's proposed point-of-sale disclosure rule?

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Comment: The NASD's action on the proposed risk disclosure brochure should be deferred until the SEC has completed its analysis and rulemaking process for its proposed rule. The NASD's rule should be shaped by the final SEC rulemaking.

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: For the reasons described above, clearly articulating the benchmarks for determining suitability is an important step to achieving more uniform application of the NASD's "best practices" or the Proposed Rule. SAI strongly urges the NASD to assign the responsibility for gathering input from a variety of interested and disinterested sources and synthesizing appropriate metrics to a joint task force. Those standards would be best presented as rebuttable presumptions, together with a description of factors that may justify going beyond the presumptive benchmarks.

Recommendations

- 1) **Continue to Promote Investor Education.** The NASD should work closely with the SEC and the insurance industry to create an industry-wide educational brochure that could be provided to investors prior to completing an initial variable annuity transaction. The options disclosure brochure and the penny stock disclosure brochure are good examples of how a disclosure document can address important risk issues in a general format using plain English language.

Written, product-specific disclosures made at the point of sale should be made through the prospectus and not another product-specific disclosure document. However, if the NASD believes that additional product-specific disclosures are necessary then we believe that those documents should be prepared by the issuing insurance companies and filed with the SEC as a part of their registration statements. This approach would best assure accuracy, completeness, and uniformity of disclosures with the lowest overall cost of implementation. If the NASD believes that this is the best course, it could recommend that the SEC make the appropriate changes to its regulations.

- 2) **Develop and Publish "Red Flag" Benchmarks.** We respectfully urge the NASD to work with industry members to define more specific "red flag" benchmarks to be used in the supervision of variable annuity business.

Conclusion

We believe that increased education of consumers and industry personnel will go a long way to help correct many of the concerns noted in NTM 04-45. To the extent that the NASD finds that additional reform is necessary, we respectfully request that the NASD be mindful of the comments and suggestions outlined in this letter.

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Thank you for the opportunity to submit these comments. If you would like to discuss any of these issues further you are welcome to contact me in writing at the following address:

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Omaha, NE 68106

Sincerely,
Securities America, Inc.

A handwritten signature in black ink, appearing to read 'D. Spinar', with a large, stylized 'X' or cross-like flourish extending from the end of the signature.

David O. Spinar
Vice President and Chief Compliance Officer