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August 9, 2004

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

Re: Proposed Rule Governing the Purchase, Sale or Exchange of Deferred Variable Annuities – NTM 04-45

Dear Ms. Sweeney:

TIAA-CREF Individual & Institutional Services, LLC ("Services") is pleased to submit comments on the subject NASD proposal to improve variable annuity sales practices and to enhance customer understanding of these products. Services is the distributor for College Retirement Equities Fund ("CREF") and for the Teachers Insurance and Annuity Association of America ("TIAA") Real Estate Account. TIAA and CREF (together, "TIAA-CREF") fully support the comprehensive standards for supervision and suitability provided under the NASD conduct rules and the SEC's regulations and interpretations. We also believe that improved sales practices and efforts to deepen customer understanding of the complexities of variable annuity products would allow individuals to make great strides toward reaching better informed and more intelligent decisions on the suitability of a purchase, sale or exchange of a particular variable annuity. We applaud the NASD's efforts to highlight the significant impact improper variable annuity sales practices and unsuitable variable annuity product features can have on the attainment of an individual's investment objectives.

While we recognize that the NASD has independent authority to regulate the sales practices and supervisory requirements that are the subject of the proposal, we have focused on the impact of these rules in light of other existing regulatory structures that create overlapping standards. Our comments are intended to improve the effectiveness of these rules as they apply in conjunction with other federal and state laws. Despite our support for the laudable goals of the proposal, we believe its impact is unnecessarily broad. The far-reaching range of the proposal would cause employee benefit plan investment offerings that are already subject to review by plan fiduciaries, and are currently subject to rigorous fiduciary standards under the Employee Retirement Security Act of 1974 ("ERISA"), to become subject to duplicative and perhaps somewhat disjointed standards. We recommend that variable annuities that fund pension plans be excluded from the scope of this proposal. We also recommend that the proposal be revised to avoid causing the mechanical problems it would create in those scenarios where its scope might otherwise apply.

Background

Services is a broker-dealer registered with the SEC and is a NASD member firm. Services is engaged in the distribution of variable annuities and interests issued by CREF and the TIAA Real Estate Account in connection with retirement planning services offered to institutions, including colleges, universities and non-profit institutions, as well as governmental entities. It also distributes retail and institutional mutual funds, after-tax variable annuities and interests in state college tuition savings programs.

CREF is an SEC registered open-end diversified investment management company. Its companion organization, TIAA, is a non-profit life insurance company regulated by the New York State Insurance Department. Together, TIAA-CREF comprises the principal retirement system for the nation's education and research communities. TIAA-CREF serves over 2.9 million people at over 15,000 United States institutions and jointly manages over $300 billion in assets. As one of the nation's largest institutional investors, CREF holds shares in over 5,000 portfolio companies.

Comments on Proposed Rule

Scope of the Proposal. We commend the NASD for its thoughtful initiative to ensure that a suitability analysis and review are performed prior to the purchase, sale or exchange of a deferred variable annuity, and to mandate clarification of some of the complexities of variable annuities. In the context of an employer sponsored tax deferred annuity plan, however, we believe the protections currently afforded by ERISA regulate these matters effectively. ERISA and the Department of Labor place the obligation on plan fiduciaries to select suitable investment vehicles for an employer sponsored tax deferred annuity plan. The plan fiduciary is obligated to perform the due diligence needed to ensure that an annuity contract offered to fund an ERISA defined pension plan is suitable for the retirement planning purposes of its plan participants and beneficiaries. ERISA is intended to provide a maximum degree of protection to the individuals covered by a retirement plan.

A pension plan that is subject to the fiduciary responsibility rules under ERISA, as well as one that is subject to fiduciary responsibility rules existing under common law or applicable state statute, afford to individuals protections sufficiently similar to the protections sought by the subject proposal. Section 404(a) of ERISA sets forth a standard of conduct to which a plan fiduciary must conform in the discharge of his or her duties. These duties include the duty: (i) to act solely in the interests of plan participants and their beneficiaries, (ii) to act for the exclusive purpose of providing benefits to plan participants and their beneficiaries and defraying reasonable expenses of administering the plan, and (iii) to exercise the care, skill, prudence and diligence under the circumstances that a prudent person acting in a like capacity and familiar with such matters would exercise.

A variable annuity contract offered to fund a pension plan as defined in Section 3(2) of ERISA should not be subject to the suitability and principal review provisions of this proposal because a plan fiduciary will have already determined that any annuity contract offered under the

plan is a suitable plan investment alternative for the plan's participants. The exclusion should extend to all ERISA defined pension plans that are subject to Section 401(a) of the Internal Revenue Code of 1986, as amended (the "Code"), Section 403(b) of the Code and Section 457(b) of the Code, including plans maintained under these Code sections by governmental entities.

In order to satisfy due diligence obligations, a plan fiduciary of any such plan is obligated to determine the material features of a variable annuity contract that will be made available for funding and to determine that the particular annuity and its underlying investment alternatives are suitable for retirement purposes. In essence, a plan fiduciary performs a threshold suitability analysis on behalf of each individual participant. As part of any suitability analysis, we believe that fiduciaries and participants alike take the perspective that all individuals have long-term objectives when contemplating their retirement planning.

Only after the threshold fiduciary analysis is performed, is an individual participant of an ERISA defined pension plan given the opportunity to elect to allocate funds to a particular funding vehicle. Consequently, there should be no need to determine on an individual-by-individual basis that an annuity contract is a suitable retirement plan investment vehicle. Application of an additional, overlapping regulatory structure would impose unnecessary burdens without providing additional protections of significance. Note that we are not seeking a change with respect to the underlying investments of a deferred variable annuity contract. With regard to the underlying investments, we support the need for a suitability analysis in conjunction with a recommendation.

A governmental plan, as defined in Section 3(32) of ERISA, operates in the same manner as a pension plan of a non-governmental employer for these purposes. In the case of a pension plan maintained by a governmental employer, a similar threshold determination is made as to whether a particular investment vehicle is a suitable retirement plan investment vehicle. We therefore recommend that an annuity contract that funds governmental pension plans maintained under Sections 401(a), 403(b) and 457(b) be likewise excluded from the scope of this proposal.

Disclosure and Prospectus Delivery. In the context of retirement plans, the disclosure and prospectus delivery-timing requirement raises distinctive issues. Under current law, different prospectus delivery requirements apply to retirement plans depending upon the nature of the particular retirement plan arrangement. Many retirement plans are not subject to the disclosure delivery requirements that apply outside the retirement plan context. Frequently, a retirement plan participant will not receive a prospectus until after enrollment. In these cases, the prospectus should be delivered no later than the time of the immediate confirmation of the transaction (i.e., immediately upon investment of the money). We fully support the practice of delivering a prospectus no later than the date of delivery of the first transaction confirmation. The prospectus delivery practice serves to protect the interests of plan participants. This practice also helps to ensure compliance with Section 404(c) of ERISA, which is designed to facilitate shifting control and potential liability over plan investments to participants only if, among other requirements, participants receive sufficient information to enable them to make informed investment decisions.

In addition, the disclosure and prospectus delivery-timing requirement is troubling in the context of a retirement plan with a negative election feature. A negative election is retirement

plan feature pursuant to which a fixed, stated percentage of an employee's salary is contributed to a retirement plan on behalf of an employee, in the absence of an affirmative election by the employee. When the fixed amount is contributed to the retirement plan it is allocated to a stated investment alternative. This process continues, pending any future overriding election by the employee. In order to be a valid negative election, the individual employee must be given adequate notice and a reasonable period of time to make an affirmative election to the contrary.

The concept behind a negative election is that despite the absence of an affirmative action by an individual who is eligible to participate in a plan, the compelling public policy of encouraging individuals to save for their retirement outweighs competing public policies supported by an affirmative decision. The balancing of competing public policies seems to be swayed, in part, by the fiduciary considerations a plan fiduciary would need to take into account in order to decide on a suitable investment vehicle to receive the allocation and the appropriate percentage of salary to be contributed. The Internal Revenue Service has sanctioned the use of negative elections as a way of encouraging the U.S. population to save for retirement, and negative elections have become a common feature in Code Section 401(k) plans and Code Section 403(b) plans.

Companies that fund retirement plans whose terms provide for negative elections have not necessarily had any interaction with an individual employee at the time a negative election is made. It is the lack of any action taken by the employee, including a failure to actively elect any investment option under the plan, that is the root of the negative election provision. As a practical matter, the funding company frequently would not even be aware of the identity of such an individual prior to the initial contribution. As such, the proposal would put retirement plan funding companies in the unenviable position of not having the identifying information it would need to comply and would put plan participants in the unenviable position of perhaps losing retirement savings opportunities.

The broad language of the proposal also creates potential ambiguity. The language requires disclosure and prospectus delivery prior to effecting a purchase, sale or exchange of a deferred variable annuity. We seek clarification that the proposal is intended to encompass only an initial purchase, sale or exchange of a deferred variable annuity contract. In addition, we seek clarification that the proposal is intended to exclude from its scope the subsequent sub-account purchases offered to contract owners that arise in the case of subsequent contributions to the same annuity contract and that the proposal is also intended to exclude from its scope future reallocations, exchanges and transfers within the same annuity contract. We don't believe a broader interpretation of this aspect of the proposal is intended or would provide any added value to an individual.

Exchange or Replacement of a Deferred Annuity. TIAA-CREF supports the NASD's efforts to prevent the sale of unsuitable deferred variable annuities in the context of effecting an exchange or replacement of a deferred variable annuity. While we applaud the NASD's attempt to protect investors from inappropriate replacements, complying with the NASD's new proposed replacement procedures, in addition to the likely conflicting requirements set forth by the state insurance regulatory regime, will be overly burdensome. The state insurance statutes and regulations governing replacements have been carefully crafted to specifically target those types of annuities and circumstances where it appears likely that the exchange or sale of the annuity

may give rise to a question of the appropriateness of the sale. These statutes and regulations have also provided appropriate exemptions for certain products and activities where it is highly unlikely that there would be any incentive for a member to make an unsuitable replacement sale. For example, many state insurance laws exempt internal replacements if the customer is exercising a contractual change or conversion privilege. In addition, many states differentiate between agent sales and direct response sales with respect to the severity of the replacement requirements since unsuitable sales that occur seem to occur predominantly in the agent sales context.

We suggest instead that the NASD could effect the same change in behavior by requiring the member to include as part of its suitability decision a determination that it had complied with the applicable state insurance law with respect to replacements. Likewise, in paragraph (c)(3) of this proposed rule, instead of requiring that the principal review, approve and sign the specific replacement form required by paragraph (b)(2) of this rule, the NASD could include compliance with state insurance laws on replacements as one of the items the principal must consider under paragraph (c)(1) of this proposed rule. This would clearly tie together the NASD's interests in making sure that replacement issues have been considered in making a suitability determination with the states' currently existing regulatory scheme for replacements.

As a practical matter, we also note that it may be extremely difficult to comply with the part of the proposal that requires a comparison of all significant differences between a member's variable annuity and a customer's existing variable annuity. Although this may be difficult in normal circumstances, it would be nearly impossible for sales made over the Internet where the customer initiates the purchase and by choice has no interaction with a representative. Perhaps one solution would be to limit the requirement for the comparison to replacements made through agent sales. In the event the NASD continues to favor the current proposal on replacements, we believe that ERISA defined pension plans should be exempt from these requirements for the reasons set forth under Scope of the Proposal above.

Principal Review. A one-day turn around for principal review creates impractical and unnecessary mechanical burdens on the variable annuity industry. The existence of state mandated free look periods seems to eliminate the need for an onerous turnaround time. In addition, circumstances surrounding sales and purchases would raise practical compliance difficulties. For example, in the context of pension plan variable annuity applications, enrollments of new pension plan participants at institutions of higher education frequently occur on a university campus. A principal might very well not have access to these applications and the supporting suitability data within the prescribed one-day period. In the event a principal review were to be deemed necessary, we suggest that a more practical approach would be to impose a principal review requirement following receipt of a variable annuity application at a centralized location, with a lengthier turnaround time.

Conclusion

We commend the NASD for taking this initiative to provide individual investors with more meaningful and understandable information about variable annuity products. We submit these comments with the intention of supporting the initiative within the context of other regulatory structures that govern. We hope to avoid duplicative and conflicting regulatory standards. We would appreciate the opportunity to discuss our thoughts in person on this important initiative with the NASD staff and will call you in a few weeks to arrange for a meeting. If you would like to discuss this matter with us in the interim, please feel free to call Monica Calhoun at (303) 607-2012 or me at (212) 916-6485.

Very truly yours,

Gary E. Herzlich