August 2, 2004

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

Re: Request for Comment on Proposed Variable Annuity Purchase, Sale, or Exchange Rules

To Whom It May Concern:

Thank you for the opportunity to provide feedback on Notice To Members 04-45. The abuse of the purchase, sale, and exchange of variable annuities is a great concern to the industry, especially to members who believe the product is extremely valuable for some members of the investing public. My general concern is that several of the points in NTM 04-45 will not achieve relief in reducing abusive sales practices and will instead potentially lead members and registered persons to stop selling the products completely, even where appropriate.

Let me begin by providing some perspective in my own personal history with variable annuities. I have been a registered representative since 1993 and have sold variable annuities personally. I have also been the president of an independent broker/dealer since 2000, and therefore have a member firm supervisory perspective as well.

Generally, my concerns center on the following points:

1. The assumption that the disclosures proposed in NTM 0445 are appropriate for VA's and not for all registered investment products.
2. The possibility that this additional disclosure document will be considered a substitute prospectus and open up the firm to increased liability as well as diminish the value of the real prospectus for investors.
3. The challenge of providing the additional disclosure document accurately will cause a burden to member firms that is unreasonable and can be better achieved by the product sponsor or distributing firm.
4. The assumption that qualified monies in a variable annuity is an unusually bad investment decision is false and diminishes the significant value that the insurance component of variable annuities brings to the investor.
5. Several of the specific disclosure items are irrelevant and make poor assumptions.
6. Several of the specific supervisory items are misleading and also make misleading assumptions about the product.
7. The obligations for unsolicited sales are too vague and don't seem reasonable.
8. The timeframes for supervisory review are not workable.
9. Gathering information about prior policies is not always possible.
10. The disclosure of fees will be difficult and confusing to the investor unless a standard is set.

Detailed discussion:

The assumption that the disclosures proposed in NTM 0445 are appropriate for VA's and not for all registered investment products seems to be a dangerous precedent. While I am not advocating additional disclosure for all registered products, what I do see as an unbalanced burden on annuity products seems misleading to investors. If I were faced with the situation as a new investor where the decision between buying a mutual fund or an equity indexed annuity required only minimal disclosure (a prospectus and any applicable switch form) and a variable annuity required a lengthy document in addition to the prospectus, how can I not assume that the mutual fund or equity indexed annuity is a less risky investment? Most investors should know most of the same information about the mutual fund that you suggest they know about the variable annuity – yet we are only providing a “separate, brief, and easy-to-read” risk disclosure document for the v.a. Ask most investors if they know the same details about their mutual fund or fixed annuity purchase, and they will tell you “no.” Why the disparity? Let’s solve the big picture and either establish better standards for prospectus disclosure through the SEC, establish standards for prospectus products in general (the burden should be placed on the product company or its distributing wholesale company).

The possibility that this additional disclosure document will be considered a substitute prospectus and open up the firm to increased liability as well as diminish the value of the real prospectus for investors is a real concern to member firms and registered representatives. I am very concerned that the disclosure document will undermine the prospectus as a viable source of information for investors. I am equally concerned that no matter how much information the disclosure document provides, additional critical information will not be available within the document and will create a situation where the representative cannot defend him/herself in any case where an investor becomes unhappy with the investment due to standard market risk issues. Any item not disclosed in the disclosure document can be deemed not important enough to warrant disclosure by the investment professional and will lead to an open invitation for the prosecution to claim failure to properly disclose the critical item.

The challenge of providing the additional disclosure document accurately will cause a burden to member firms that is unreasonable and can be better achieved by the product sponsor or distributing firm. The disclosure document will include information that is repetitive, set by prospectus, detailed in nature, and sometimes altered by additions to the prospectus – making unintentional errors very possible.

This responsibility should fall squarely on the shoulders of the product sponsor or the member firms who distribute the product, not the sales person. The lack of standards for the disclosure document will create even more confusion within the industry. If we are to move forward with the disclosure document, let’s make sure we get the following:

1. An industry standard document, and
2. Product specific information provided by the product sponsor or it’s distributing member firm.

The challenge of providing the additional disclosure document accurately will cause a burden to member firms that is unreasonable and can be better achieved by the product sponsor or distributing firm. While I understand that the NASD does not exercise control over the Variable Annuity manufacturing firms, I believe that the wholesaling companies are, by definition, member firms, and this responsibility can be placed with them. This is an area rife with potential for unintentional errors and exponential inefficiency, as every member firm creates a different document and gets the same information repeatedly.

The assumption that qualified monies in a variable annuity is an unusually bad investment decision is false and diminishes the significant value that the insurance component of variable annuities brings to the investor. As participation in defined contribution plans continues to explode in the United States, qualified plan assets continue to rival real estate as the most significant asset in an individual’s portfolio. The assumption by NASD that the insurance component of variable annuities is not significant enough to warrant protection of qualified assets is naïve, if not downright dangerous to the investing public. The SEC cites the SmartMoney.com article which compares the annual expense charges of mutual funds with variable annuities and provides a very unbalanced portrayal of the insurance portion of the annuity product. When presented with the ability to protect the most significant liquid asset of a couple's household, vs. leave the asset unprotected and when many of the new living benefits are considered, the value of a variable annuity for qualified money is undeniable. I recently reviewed a product that can guarantee a 7% withdrawal of assets for at least 14 years or a 5% minimum return prior to annuitization for 40 basis points. In effect, these cost-effective considerations give defined contribution participants some of the same peace-of-mind that traditional pension participants have had (arguably better, given the recent demise of several corporate defined benefit plans.) The mission of the NASD to insure that investors know that variable annuities don't provide tax deferral benefits is noble, but is overshadowing the insurance component. NASD owes investors and members a balanced look at the product, just as we are held accountable for balanced portrayal of a product's virtues or shortfalls.

Several of the specific disclosure items are irrelevant and make poor assumptions.

Under "Disclosure and Prospectus Delivery" discussion of state and local government premium taxes seems incredibly difficult given the geographic spread of many individuals. "Long term investment objective" can also be inappropriate if the individual is over 59 ½ and is using the proceeds of the annuity for reasons besides supplementing income. (Example: Often individuals will segregate a portion of their assets for the benefit of funeral planning or charitable giving. This individual can then attach a guarantee of the minimal rate of return as a death benefit (7% for example) and can then invest as aggressively as possible, knowing that the charity or funeral home will receive no less than the principal plus 7% return. Typically this investor would be of an advanced age – and will again appear unsuitable under suggested review criteria.)

Also, the request that these disclosures be made "regardless of whether the transaction had been recommended" should be clarified so that it is clear that these details will be a burden only if an application is taken – not if the customer only requests the information and is not committed to doing business with the representative. Representatives should not be required to do burdensome research for individuals on products that they themselves would not recommend, unless the representative and the client intends to proceed with the transaction.

Several of the specific supervisory items are misleading and also make misleading assumptions about the product. Under the Principal Review item, registered principals are to take into account whether "the amount of money invested exceeds a stated percentage of the customer's net worth or is more than a stated dollar amount." This request assumes too many factors to even be relevant. Again, why would this information be specific to variable annuities if the age of the client is appropriate for the purchase? How will a member firm possibly arrive at a fixed dollar amount that is worthy of gaining principal protection at death or during life with some products?

Additionally, asking the principal to consider the number of replacements or exchanges the customer account has had is a standard consideration for any replacement – mutual fund, annuity, life insurance, etc. But it is, again, assuming too many factors to be relevant – ex: a sales charge has been applied, a loss of benefits, an increase in fees, etc.

These products are rapidly evolving and, fortunately, often improving. Please don't mislead principals into thinking that one replacement is not worth as much review as the third replacement.

Similarly, asking the principal to consider if "the associated person effecting the transaction has a particularly high rate of effecting deferred variable annuity exchanges or replacements," is again misleading based on too many assumptions. The quality, not the quantity of the replacements should be the consideration.

Finally, the assertion that qualified retirement accounts are somehow not warranted investments is fundamentally unsound and disturbingly distracting coming from an investor protection agency. Again, without a discussion of the insurance component of the investment, (which NASD, notably does NOT recommend anywhere in NTM 04-45) the discussion of the product is useless.

The obligations for unsolicited sales are too vague and don't seem reasonable. This concern is discussed earlier in the document.

The timeframes for supervisory review are not workable. They also present the real possibility that the investors money cannot be invested in a timely manner. Many firms do not have on-site supervisors for acceptance and review in such a short time frame, and instead will ask that the application be sent to the home office for review. Smaller firms may also suffer because the regular supervisory workload may not allow for such a review. Additionally, if more information from the investor is necessary, the review must be delayed to allow sufficient time to gather the information. If the products are as complex and challenging as you assert, then 1 day is not going to be enough time in all cases to adequately investigate the proposed investment. In addition, if you will require prior principal review, then you need to add an appropriate disclosure to the customer document that will announce to the investor that their investment assets will not be promptly forwarded to the investment product company due to required review.

Gathering information about prior policies is not always possible. The thought behind your rule proposal that would require mandatory comparison of old and new policies is sound, but, unfortunately, not always possible. Proprietary products especially, are difficult, if not impossible to research. Recently, we tried to assist a customer with some research on his current bank-broker/dealer proprietary variable annuity. We called the company directly, with the investor in our office and had him request a copy of his prospectus. We were told that because the annuity had been discontinued as a current product offering, no prospectuses were available for mailing until the annual mailing rolled around again. This would be months. Under the proposed rule, this customer would not be able to replace the product that was significantly more expensive and less suitable because he could not find his initial prospectus.

The disclosure of fees will be difficult and confusing to the investor unless a standard is set. We have noticed a trend in the last few years among the product manufacturers. In order to hide increases in internal costs, the product manufacturer are raising the costs of the sub-accounts rather than raise the M & E or administrative fees. Why? Simply because investors and investment professionals have been led to assume that M & E and administrative fees were the best comparison of internal pricing and the comparison is simple to do. Few people think to look deep enough to see that the sub-accounts are actually bearing the increased costs.
With this said, how will the average investor need to be informed of the sub-account charges? Each sub-account varies dramatically, and every allocation change within the sub-account portfolio will change the cost structure. One solution is to disclose the average cost, but that is difficult given the propensity of the annuity companies to change sub-accounts. One solution would be to provide the range, but that blurs the real cost.
My suggestion is to leave the sub-account fee disclosures to the manufacturer and the prospectus, but disclose that the sub-account fees, like mutual fund fees, are in addition to the insurance costs of the product and refer individual investors to the prospectus.

In summary:

- NTM 99-35 is appropriate.
- Consider the potential for misleading investors if no equivalent disclosures are required for mutual funds and equity indexed annuity products.

- If additional disclosure is mandated, members and their employees need protection against claims of false prospectuses.
- This disclosure should be uniform and be made the responsibility of the product vendor or manufacturer.
- The assertion that the quantity of replacements vs. the quality of replacements is relevant is misleading.
- The assertion that qualified money is somehow inappropriate within a variable annuity product is irresponsible and misleading.
- The insurance component and the benefits it provides should also be disclosed, and considered in your comparison of costs and benefits.
- Net worth percentage and absolute value are poor and often irrelevant metrics for appropriate review.
- Consider the following metrics instead:

A. Real Dollar Value and percentage of CDSC, if exchanged from another product.
B. Increase/Decrease of commitment for new product (7 years started over or no commitment, etc.)
C. Increase/Decrease of market risk exposure.
D. Increase/Decrease of death benefit protection. (Mutual funds would be required to show that they don't provide any death protection.)
E. Relevant Tax issues due to replacement.
F. Age-related issues (focus more on under 59 ½ rather than assign a maximum age.)
G. Disclose that returns do/do not consider all applicable expenses.

Thank you for your consideration of the issues raised in this letter.

Sincerely,

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President
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