

OMB APPROVAL

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2004 - 183
Amendment No. 4

Proposed Rule Change by National Association of Securities Dealers
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial ☐	Amendment ☒	Withdrawal ☐	Section 19(b)(2) ☒	Section 19(b)(3)(A) ☐	Section 19(b)(3)(B) ☐
			Rule		
Pilot ☐	Extension of Time Period for Commission Action ☐	Date Expires 	☐ 19b-4(f)(1) ☐ 19b-4(f)(2) ☐ 19b-4(f)(3)	☐ 19b-4(f)(4) ☐ 19b-4(f)(5) ☐ 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document
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Exhibit 3 Sent As Paper Document
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Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name James Last Name Wrona
Title Associate Vice President and Associate General Counsel
E-mail jim.wrona@nasd.com
Telephone (202) 728-8270 Fax (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 03/05/2007

By Patrice Gliniecki
(Name)

Senior Vice President and Deputy General Counsel

(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

PATRICE GLINIECKI,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) Amendment No. 4 to SR-NASD-2004-183, proposed new NASD Rule 2821, which sets forth recommendation requirements (including a suitability obligation), principal review and approval requirements, and supervisory and training requirements, all tailored specifically to transactions in deferred variable annuities. The purpose of Amendment No. 4 is to modify further certain provisions. Below is the text of the proposed rule. Proposed new language is underlined.

* * * * *

2821. Members’ Responsibilities Regarding Deferred Variable Annuities

(a) General Considerations

(1) Application

This Rule applies to the purchase or exchange of a deferred variable annuity and the subaccount allocations. This Rule does not apply to reallocations of subaccounts made or to funds paid after the initial purchase or exchange of a deferred variable annuity. This Rule also does not apply to deferred variable annuity transactions made in connection with any tax-qualified, employer-sponsored retirement or benefit plan that either is defined as a “qualified plan” under Section 3(a)(12)(C) of the Securities Exchange Act of 1934 or meets the

¹ 15 U.S.C. 78s(b)(1).

requirements of Internal Revenue Code Sections 403(b), 457(b), or 457(f), unless, in the case of any such plan, a member or person associated with a member makes recommendations to an individual plan participant regarding a deferred variable annuity, in which case the Rule would apply as to the individual plan participant to whom the member or person associated with the member makes such recommendations.

(2) Creation, Storage, and Transmission of Documents

For purposes of this Rule, documents may be created, stored, and transmitted in electronic or paper form, and signatures may be evidenced in electronic or other written form.

(3) Definitions

For purposes of this Rule, the term “registered principal” shall mean a person registered as a General Securities Sales Supervisor (Series 9/10), a General Securities Principal (Series 24), or an Investment Company Products/Variable Contracts Principal (Series 26), as applicable.

(b) Recommendation Requirements

(1) No member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has a reasonable basis to believe

(A) that the transaction is suitable in accordance with Rule 2310 and, in particular, that there is a reasonable basis to believe that

(i) the customer has been informed, in general terms, of various features of deferred variable annuities, such as the

potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities; and market risk;

(ii) the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit; and

(iii) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements, if any, are suitable (and, in the case of an exchange, the transaction as a whole also is suitable) for the particular customer based on the information required by subparagraph (b)(2) of this Rule; and

(B) in the case of an exchange of a deferred variable annuity, the exchange also is consistent with the suitability determination required by subparagraph (b)(1)(A) of this Rule, taking into consideration whether

(i) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense

fees, investment advisory fees, or charges for riders and similar product enhancements);

(ii) the customer would benefit from product enhancements and improvements; and

(iii) the customer's account has had another deferred variable annuity exchange within the preceding 36 months.

The determinations required by this paragraph shall be documented and signed by the associated person recommending the transaction.

(2) Prior to recommending the purchase or exchange of a deferred variable annuity, a member or person associated with a member shall make reasonable efforts to obtain, at a minimum, information concerning the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable by the member or person associated with the member in making recommendations to customers.

(c) Principal Review and Approval

Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity. Subject to the exception in this paragraph, and treating all transactions as if they have

been recommended for purposes of this principal review, a registered principal shall approve the transaction only if the registered principal has determined that there is a reasonable basis to believe that the transaction would be suitable based on the factors delineated in paragraph (b) of this Rule. Notwithstanding the foregoing, a registered principal may authorize the processing of the transaction if the registered principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the registered principal has not approved the transaction, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity. The determinations required by this paragraph shall be documented and signed by the registered principal who reviewed and approved, rejected, or authorized the transaction.

(d) Supervisory Procedures

In addition to the general supervisory and recordkeeping requirements of Rules 3010, 3012, 3013, and 3110, a member must establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in this Rule. The member also must (1) implement surveillance procedures to determine if any of the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable NASD rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.

(e) Training

Members shall develop and document specific training policies or programs reasonably designed to ensure that associated persons who effect and registered principals who review transactions in deferred variable annuities comply with the requirements of this Rule and that they understand the material features of deferred variable annuities, including those described in subparagraph (b)(1)(A)(i) of this Rule.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on April 21, 2004, which authorized the filing of the proposed rule with the SEC. The Board of Governors of NASD had an opportunity to review the proposed rule at its meeting on April 22, 2004. No other action by NASD is necessary for the filing of the proposal. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 180 days following publication of the Notice to Members announcing Commission approval.

3. **Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule**

(a) Purpose

Rule Filing History

On December 14, 2004, NASD filed with the Commission proposed Rule 2821 (SR-NASD-2004-183). NASD filed with the Commission Amendment No. 1 to the proposal on July 8, 2005. The Commission published the proposal in the Federal Register for the first time on July 21, 2005.² The comment period closed on September 19, 2005. Based on comments received in response to the publication of the proposal in the Federal Register, on May 4, 2006, NASD filed Amendment No. 2 to SR-NASD-2004-183 to address the comments and to make certain changes. The Commission published Amendment No. 2 in the Federal Register on June 28, 2006.³ The comment period closed on July 19, 2006. NASD filed a response to comments on August 31, 2006. NASD filed Amendment No. 3 on November 15, 2006. NASD is filing Amendment No. 4 to further explain and modify certain provisions.

Proposal

As described in the original rule filing and Amendments Nos. 1, 2, and 3, NASD is proposing new NASD Rule 2821 to impose specific sales practice standards and supervisory requirements on members for transactions in deferred variable annuities, which are hybrid investments containing both securities and insurance features. The

² See Securities Exchange Act Rel. No. 52046A (July 19, 2005), 70 FR 42126 (July 21, 2005) (Notice of Filing Amendment No. 1 to SR-NASD-2004-183). The Commission did not publish the original proposal.

³ See Securities Exchange Act Rel. No. 54023 (June 21, 2006), 71 FR 36840 (June 28, 2006) (Notice of Filing Amendment No. 2 to SR-NASD-2004-183).

proposed rule has four main requirements. First, the proposal has requirements governing recommendations (including a suitability obligation) specifically tailored to deferred variable annuity transactions.⁴ Second, the proposal includes principal review obligations.⁵ Third, the proposal specifically requires members to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the standards set forth in the proposed rule.⁶ Fourth, the proposal has a training component.⁷

Modification of the Proposed Rule

NASD's Amendment No. 4 modifies the proposal in two main ways. First, NASD is modifying certain language in the "Recommendation Requirements" section of the proposal. At present, the proposed rule states that "[n]o member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has determined,"] inter alia, "that the transaction is suitable in accordance with Rule 2310." NASD is substituting the phrase "has a reasonable basis to believe" for "has determined."

Second, NASD's Amendment No. 4 changes the timing of principal review. Amendment No. 3 had allowed principals to review the transaction for up to five business days after the application for a deferred variable annuity had been transmitted to the issuing insurance company. Upon further consideration, however, NASD believes that such an approach is not workable. NASD is concerned about creating a post-transmittal

⁴ See Proposed Rule 2821(b).

⁵ See Proposed Rule 2821(c).

⁶ See Proposed Rule 2821(d).

⁷ See Proposed Rule 2821(e).

review period that theoretically would allow the insurance company to issue a contract before the broker-dealer's principal has even begun (let alone finished) the review of the transaction. This concern is heightened by the unique relationship between the customer, the broker-dealer, and the issuing insurance company. For instance, the broker-dealer's ability to cancel the deferred variable annuity contract once the insurance company has issued it to the customer can be somewhat problematic under certain circumstances. Moreover, there may be disincentives to unwinding the transaction once the insurance company has issued the contract.

To address these concerns, NASD now proposes to return to pre-transmittal review (an approach used in an earlier version of the proposal). The revised timing provision states, "Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity."⁸

Although solving the crucial concerns mentioned above, this modification raises another issue that must be addressed—namely, ensuring that all broker-dealers have

⁸ See Proposed Rule 2821(c). The principal review must be completed within the designated timeframe.

NASD also notes that the timing of principal review would not be impacted by a firm's status as a "captive broker-dealer" (e.g., a broker-dealer that is owned by, a subsidiary of, or affiliated with an insurance company). That is, NASD does not interpret Rule 2821 to mean that the application has been transmitted to the insurance company at the same time it is obtained by a person registered as a representative or principal with a "captive broker-dealer." Rather, NASD would view transmittal as occurring when the registered representative or principal actually sends the application to the insurance company for processing.

adequate time to perform a thorough principal review of these transactions. In view of the variety of features and provisions in connection with the issuance of deferred variable annuity contracts, NASD has come to understand that principal review of these investments requires greater time than reviews of many other securities transactions. The provision of a reasonable amount of time for pre-transmittal review, however, poses potential problems related to other rules concerning the handling of customer funds. For instance, NASD Rule 2330 states generally that member firms shall not make improper use of customer funds, and NASD Rule 2820 specifically requires member firms to “transmit promptly” the application and the purchase payment for a variable contract to the issuing insurance company. Similarly, SEC Rules 15c3-1 and 15c3-3 require certain member firms to promptly transmit/forward funds. SEC Rules 15c3-1(c)(9) and (10) define the terms “promptly transmit and deliver” and “promptly forward” funds as meaning “no later than noon of the next business day after receipt of such funds.”

To resolve this issue, NASD now makes clear that a broker-dealer that is holding an application for a deferred variable annuity and a non-negotiated check from a customer written to an insurance company for a period of seven business days or less would not be in violation of NASD Rules 2330 and 2820 if the reason that the application and check are being held is to allow a principal to complete his or her review of the transaction pursuant to proposed Rule 2821. In addition, NASD has asked the SEC for no-action relief regarding SEC Rules 15c3-1 and 15c3-3 when the same circumstances exist. NASD’s proposed modification to the timing of the principal review is contingent upon the SEC’s providing such no-action relief.

As noted in Item 2 of this filing, NASD will announce the effective date of the proposed rule in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 180 days following publication of the Notice to Members announcing Commission approval.

(b) Statutory Basis

NASD believes that the proposed rule is consistent with the provisions of Section 15A(b)(6) of the Act,⁹ which require, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest. NASD believes that the proposed rule is consistent with the provisions of the Act noted above in that it will enhance firms' compliance and supervisory systems and provide more comprehensive and targeted protection to investors in deferred variable annuities. As such, the proposed rule will decrease the likelihood of fraud and manipulative acts, promote just and equitable principles of trade, and increase investor protection.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Received from Members, Participants, or Others

The proposed rule has been published for comment on three occasions—once in an NASD Notice to Members before NASD filed the proposal with the Commission and

⁹ 15 U.S.C. 78o-3(b)(6).

twice in the Federal Register after NASD filed it with the Commission.¹⁰ These publications, moreover, generated substantial comments to which NASD responded. In brief, NASD has sought and received extensive feedback from participants in the securities and insurance industries, as well as the public at large, and NASD has analyzed and addressed numerous issues as part of that process.¹¹ Indeed, the significant changes that NASD has made to the proposed rule at each step in the process evidence NASD's careful and thoughtful consideration of the issues that commenters have raised.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.¹²

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

NASD requests that the Commission find good cause pursuant to Section 19(b)(2) of the Act¹³ for approving the proposed rule prior to the 30th day after its publication in the Federal Register. NASD is filing Amendment No. 4 to provide all broker-dealers with adequate time to perform important principal reviews. As such, NASD requests that

¹⁰ See NASD Notice to Members 04-45 (June 2004); Securities Exchange Act Rel. No. 52046A (July 19, 2005), 70 FR 42126 (July 21, 2005) (Notice of Filing of Amendment No. 1 to SR-NASD-2004-183); Securities Exchange Act Rel. No. 54023 (June 21, 2006), 71 FR 36840 (June 28, 2006) (Notice of Filing of Amendment No. 2 to SR-NASD-2004-183).

¹¹ See NASD's Response to Comments, dated August 31, 2006, Filed in Response to Publication of Amendment No. 2. See also NASD's Original Rule Filing, SR-NASD-2004-183, at 14-19 (Dec. 14, 2004); NASD's Amendment No. 1 to SR-NASD-2004-183, at 17-22 (July 8, 2005); Amendment No. 2 to SR-NASD-2004-183, at 36-48 (May 4, 2006).

¹² 15 U.S.C. 78s(b)(2).

the Commission accelerate the effectiveness of the proposed rule prior to the 30th day after its publication in the Federal Register.

8. Proposed Rule Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule for publication in the Federal Register.

Exhibit 2a. NASD Notice to Members 04-45 (June 2004). [Note: Exhibit 2a was submitted as part of the original rule filing and is not being resubmitted for purposes of this Amendment No. 4.]

Exhibit 2b. Index to comments received in response to NASD Notice to Members 04-45 (June 2004), submitted in hard copy. [Note: Exhibit 2b was submitted as part of the original rule filing and is not being resubmitted for purposes of this Amendment No. 4.]

Exhibit 2c. Comments received in response to NASD Notice to Members 04-45 (June 2004), submitted in hard copy. [Note: Exhibit 2c was submitted as part of the original rule filing and is not being resubmitted for purposes of this Amendment No. 4.]

Exhibit 3. Not applicable.

Exhibit 4. This exhibit shows changes proposed in Amendment No. 4 of this filing with the language proposed in the initial rule filing and Amendments Nos. 1, 2, and 3 shown as if previously adopted.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2004-183)

Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 14, 2004, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) and amended on July 8, 2005, May 4, 2006, November 15, 2006, and March 5, 2007,³ the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 to SR-NASD-2004-183 replaced and superseded the text of the original rule filing filed on December 14, 2004, except Exhibit 2a, Exhibit 2b, and Exhibit 2c. Amendment No. 2 to SR-NASD-2004-183 addressed the comment letters that the Commission received in response to the publication of the proposed rule in the Federal Register and proposed amendments responsive to the comments where appropriate. Amendment No. 3 to SR-NASD-2004-183 further modified various provisions in response to comments. Amendment No. 4 to SR-NASD-2004-183 modified certain language in the “Recommendation Requirements” section of the proposal to make clear that a person has to have a “reasonable basis” to believe the transaction is, inter alia, suitable and it altered the timing of principal review in the “Principal Review and Approval” section by requiring a principal to complete his or her review of the transaction prior to transmitting the application for the deferred variable annuity to the insurance company.

persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD is proposing to adopt a new rule, proposed NASD Rule 2821, that sets forth recommendation requirements (including a suitability obligation), principal review and approval requirements, and supervisory and training requirements, all tailored specifically to transactions in deferred variable annuities. Below is the text of the proposed rule change. Proposed new language is in italics.

* * * * *

2821. Members' Responsibilities Regarding Deferred Variable Annuities

(a) General Considerations

(1) Application

This Rule applies to the purchase or exchange of a deferred variable annuity and the subaccount allocations. This Rule does not apply to reallocations of subaccounts made or to funds paid after the initial purchase or exchange of a deferred variable annuity. This Rule also does not apply to deferred variable annuity transactions made in connection with any tax-qualified, employer-sponsored retirement or benefit plan that either is defined as a "qualified plan" under Section 3(a)(12)(C) of the Securities Exchange Act of 1934 or meets the requirements of Internal Revenue Code Sections 403(b), 457(b), or 457(f), unless, in the case of any such plan, a member or person associated with a member makes recommendations to an individual plan participant regarding a deferred variable annuity, in which case the Rule would apply as to the individual plan participant

to whom the member or person associated with the member makes such recommendations.

(2) Creation, Storage, and Transmission of Documents

For purposes of this Rule, documents may be created, stored, and transmitted in electronic or paper form, and signatures may be evidenced in electronic or other written form.

(3) Definitions

For purposes of this Rule, the term “registered principal” shall mean a person registered as a General Securities Sales Supervisor (Series 9/10), a General Securities Principal (Series 24), or an Investment Company Products/Variable Contracts Principal (Series 26), as applicable.

(b) Recommendation Requirements

(1) No member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has a reasonable basis to believe

(A) that the transaction is suitable in accordance with Rule 2310 and, in particular, that there is a reasonable basis to believe that

(i) the customer has been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the

insurance and investment components of deferred variable annuities; and market risk;

(ii) the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit; and

(iii) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements, if any, are suitable (and, in the case of an exchange, the transaction as a whole also is suitable) for the particular customer based on the information required by subparagraph (b)(2) of this Rule; and

(B) in the case of an exchange of a deferred variable annuity, the exchange also is consistent with the suitability determination required by subparagraph (b)(1)(A) of this Rule, taking into consideration whether

(i) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements);

(ii) the customer would benefit from product enhancements and improvements; and

(iii) the customer's account has had another deferred variable annuity exchange within the preceding 36 months.

The determinations required by this paragraph shall be documented and signed by the associated person recommending the transaction.

(2) Prior to recommending the purchase or exchange of a deferred variable annuity, a member or person associated with a member shall make reasonable efforts to obtain, at a minimum, information concerning the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable by the member or person associated with the member in making recommendations to customers.

(c) Principal Review and Approval

Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity. Subject to the exception in this paragraph, and treating all transactions as if they have been recommended for purposes of this principal review, a registered principal shall approve the transaction only if the registered principal has determined that there is a reasonable basis to believe that the transaction would be suitable based on the factors delineated in paragraph (b) of this Rule. Notwithstanding the foregoing, a registered

principal may authorize the processing of the transaction if the registered principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the registered principal has not approved the transaction, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity. The determinations required by this paragraph shall be documented and signed by the registered principal who reviewed and approved, rejected, or authorized the transaction.

(d) Supervisory Procedures

In addition to the general supervisory and recordkeeping requirements of Rules 3010, 3012, 3013, and 3110, a member must establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in this Rule. The member also must (1) implement surveillance procedures to determine if any of the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable NASD rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.

(e) Training

Members shall develop and document specific training policies or programs reasonably designed to ensure that associated persons who effect and registered principals who review transactions in deferred variable annuities comply with the

requirements of this Rule and that they understand the material features of deferred variable annuities, including those described in subparagraph (b)(1)(A)(i) of this Rule.

* * * * *

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Rule Filing History

On December 14, 2004, NASD filed with the Commission proposed Rule 2821 (SR-NASD-2004-183). NASD filed with the Commission Amendment No. 1 to the proposal on July 8, 2005. The Commission published the proposal in the Federal Register for the first time on July 21, 2005.⁴ The comment period closed on September 19, 2005. Based on comments received in response to the publication of the proposal in the Federal Register, on May 4, 2006, NASD filed Amendment No. 2 to SR-NASD-2004-183 to address the comments and to make certain changes. The Commission

⁴ See Securities Exchange Act Rel. No. 52046A (July 19, 2005), 70 FR 42126 (July 21, 2005) (Notice of Filing Amendment No. 1 to SR-NASD-2004-183). The Commission did not publish the original proposal.

published Amendment No. 2 in the Federal Register on June 28, 2006.⁵ The comment period closed on July 19, 2006. NASD filed a response to comments on August 31, 2006. NASD filed Amendment No. 3 on November 15, 2006. NASD is filing Amendment No. 4 to further explain and modify certain provisions.

Proposal

As described in the original rule filing and Amendments Nos. 1, 2, and 3, NASD is proposing new NASD Rule 2821 to impose specific sales practice standards and supervisory requirements on members for transactions in deferred variable annuities, which are hybrid investments containing both securities and insurance features. The proposed rule has four main requirements. First, the proposal has requirements governing recommendations (including a suitability obligation) specifically tailored to deferred variable annuity transactions.⁶ Second, the proposal includes principal review obligations.⁷ Third, the proposal specifically requires members to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the standards set forth in the proposed rule.⁸ Fourth, the proposal has a training component.⁹

⁵ See Securities Exchange Act Rel. No. 54023 (June 21, 2006), 71 FR 36840 (June 28, 2006) (Notice of Filing Amendment No. 2 to SR-NASD-2004-183).

⁶ See Proposed Rule 2821(b).

⁷ See Proposed Rule 2821(c).

⁸ See Proposed Rule 2821(d).

⁹ See Proposed Rule 2821(e).

Modification of the Proposed Rule

NASD's Amendment No. 4 modifies the proposal in two main ways. First, NASD is modifying certain language in the "Recommendation Requirements" section of the proposal. At present, the proposed rule states that "[n]o member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has determined,"] inter alia, "that the transaction is suitable in accordance with Rule 2310." NASD is substituting the phrase "has a reasonable basis to believe" for "has determined."

Second, NASD's Amendment No. 4 changes the timing of principal review. Amendment No. 3 had allowed principals to review the transaction for up to five business days after the application for a deferred variable annuity had been transmitted to the issuing insurance company. Upon further consideration, however, NASD believes that such an approach is not workable. NASD is concerned about creating a post-transmittal review period that theoretically would allow the insurance company to issue a contract before the broker-dealer's principal has even begun (let alone finished) the review of the transaction. This concern is heightened by the unique relationship between the customer, the broker-dealer, and the issuing insurance company. For instance, the broker-dealer's ability to cancel the deferred variable annuity contract once the insurance company has issued it to the customer can be somewhat problematic under certain circumstances. Moreover, there may be disincentives to unwinding the transaction once the insurance company has issued the contract.

To address these concerns, NASD now proposes to return to pre-transmittal review (an approach used in an earlier version of the proposal). The revised timing

provision states, “Prior to transmitting a customer’s application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity.”¹⁰

Although solving the crucial concerns mentioned above, this modification raises another issue that must be addressed—namely, ensuring that all broker-dealers have adequate time to perform a thorough principal review of these transactions. In view of the variety of features and provisions in connection with the issuance of deferred variable annuity contracts, NASD has come to understand that principal review of these investments requires greater time than reviews of many other securities transactions. The provision of a reasonable amount of time for pre-transmittal review, however, poses potential problems related to other rules concerning the handling of customer funds. For instance, NASD Rule 2330 states generally that member firms shall not make improper use of customer funds, and NASD Rule 2820 specifically requires member firms to “transmit promptly” the application and the purchase payment for a variable contract to the issuing insurance company. Similarly, SEC Rules 15c3-1 and 15c3-3 require certain

¹⁰ See Proposed Rule 2821(c). The principal review must be completed within the designated timeframe.

NASD also notes that the timing of principal review would not be impacted by a firm’s status as a “captive broker-dealer” (e.g., a broker-dealer that is owned by, a subsidiary of, or affiliated with an insurance company). That is, NASD does not interpret Rule 2821 to mean that the application has been transmitted to the insurance company at the same time it is obtained by a person registered as a representative or principal with a “captive broker-dealer.” Rather, NASD would view transmittal as occurring when the registered representative or principal actually sends the application to the insurance company for processing.

member firms to promptly transmit/forward funds. SEC Rules 15c3-1(c)(9) and (10) define the terms “promptly transmit and deliver” and “promptly forward” funds as meaning “no later than noon of the next business day after receipt of such funds.”

To resolve this issue, NASD now makes clear that a broker-dealer that is holding an application for a deferred variable annuity and a non-negotiated check from a customer written to an insurance company for a period of seven business days or less would not be in violation of NASD Rules 2330 and 2820 if the reason that the application and check are being held is to allow a principal to complete his or her review of the transaction pursuant to proposed Rule 2821. In addition, NASD has asked the SEC for no-action relief regarding SEC Rules 15c3-1 and 15c3-3 when the same circumstances exist. NASD’s proposed modification to the timing of the principal review is contingent upon the SEC’s providing such no-action relief.

NASD will announce the effective date of the proposed rule in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 180 days following publication of the Notice to Members announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule is consistent with the provisions of Section 15A(b)(6) of the Act,¹¹ which require, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest. NASD believes that the proposed rule is consistent with the provisions of the Act noted

¹¹ 15 U.S.C. 78o-3(b)(6).

above in that it will enhance firms' compliance and supervisory systems and provide more comprehensive and targeted protection to investors in deferred variable annuities. As such, the proposed rule will decrease the likelihood of fraud and manipulative acts, promote just and equitable principles of trade, and increase investor protection.

B. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed Rule has been published for comment on three occasions—once in an NASD Notice to Members before NASD filed the proposal with the Commission and twice in the Federal Register after NASD filed it with the Commission.¹² These publications, moreover, generated substantial comments to which NASD responded. In brief, NASD has sought and received extensive feedback from participants in the securities and insurance industries, as well as the public at large, and NASD has analyzed and addressed numerous issues as part of that process.¹³ Indeed, the significant changes

¹² See NASD Notice to Members 04-45 (June 2004); Securities Exchange Act Rel. No. 52046A (July 19, 2005), 70 FR 42126 (July 21, 2005) (Notice of Filing of Amendment No. 1 to SR-NASD-2004-183); Securities Exchange Act Rel. No. 54023 (June 21, 2006), 71 FR 36840 (June 28, 2006) (Notice of Filing of Amendment No. 2 to SR-NASD-2004-183).

¹³ See NASD's Response to Comments, dated August 31, 2006, Filed in Response to Publication of Amendment No. 2. See also NASD's Original Rule Filing, SR-NASD-2004-183, at 14-19 (Dec. 14, 2004); NASD's Amendment No. 1 to SR-NASD-2004-183, at 17-22 (July 8, 2005); Amendment No. 2 to SR-NASD-2004-183, at 36-48 (May 4, 2006).

that NASD has made to the proposed rule at each step in the process evidence NASD's careful and thoughtful consideration of the issues that commenters have raised.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

NASD has requested that the Commission find good cause pursuant to Section 19(b)(2) of the Act¹⁴ for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NASD and, in particular, the requirements of Section 15A of the Act and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval is warranted because Amendment No. 4 provides all broker-dealers with adequate time to perform important principal reviews. As such, NASD requests that the Commission accelerate the effectiveness of the proposed rule prior to the 30th day after its publication in the Federal Register.

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

¹⁴ 15 U.S.C. 78s(b)(2).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2004-183 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2004-183. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of NASD.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2004-183 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Nancy M. Morris

Secretary

¹⁵ 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Exhibit 4 shows changes proposed in Amendment No. 4 of this filing with the language proposed in the initial rule filing and Amendments Nos. 1, 2 and 3 shown as if previously adopted. The new language proposed in Amendment No. 4 is underlined; deletions proposed in Amendment No. 4 are bracketed.

* * * * *

2821. Members' Responsibilities Regarding Deferred Variable Annuities

(a) General Considerations

(1) Application

This Rule applies to the purchase or exchange of a deferred variable annuity and the subaccount allocations. This Rule does not apply to reallocations of subaccounts made or to funds paid after the initial purchase or exchange of a deferred variable annuity. This Rule also does not apply to deferred variable annuity transactions made in connection with any tax-qualified, employer-sponsored retirement or benefit plan that either is defined as a “qualified plan” under Section 3(a)(12)(C) of the Securities Exchange Act of 1934 or meets the requirements of Internal Revenue Code Sections 403(b), 457(b), or 457(f), unless, in the case of any such plan, a member or person associated with a member makes recommendations to an individual plan participant regarding a deferred variable annuity, in which case the Rule would apply as to the individual plan participant to whom the member or person associated with the member makes such recommendations.

(2) Creation, Storage, and Transmission of Documents

For purposes of this Rule, documents may be created, stored, and transmitted in electronic or paper form, and signatures may be evidenced in electronic or other written form.

(3) Definitions

For purposes of this Rule, the term “registered principal” shall mean a person registered as a General Securities Sales Supervisor (Series 9/10), a General Securities Principal (Series 24), or an Investment Company Products/Variable Contracts Principal (Series 26), as applicable.

(b) Recommendation Requirements

(1) No member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has [determined] a reasonable basis to believe

(A) that the transaction is suitable in accordance with Rule 2310 and, in particular, that there is a reasonable basis to believe that

(i) the customer has been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the

insurance and investment components of deferred variable annuities; and market risk;

(ii) the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit; and

(iii) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements, if any, are suitable (and, in the case of an exchange, the transaction as a whole also is suitable) for the particular customer based on the information required by subparagraph (b)(2) of this Rule; and

(B) in the case of an exchange of a deferred variable annuity, the exchange also is consistent with the suitability determination required by subparagraph (b)(1)(A) of this Rule, taking into consideration whether

(i) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements);

(ii) the customer would benefit from product enhancements and improvements; and

(iii) the customer's account has had another deferred variable annuity exchange within the preceding 36 months.

The determinations required by this paragraph shall be documented and signed by the associated person recommending the transaction.

(2) Prior to recommending the purchase or exchange of a deferred variable annuity, a member or person associated with a member shall make reasonable efforts to obtain, at a minimum, information concerning the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable by the member or person associated with the member in making recommendations to customers.

(c) Principal Review and Approval

Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application [No later than two business days following the date when a member or person associated with a member transmits a customer's application for a deferred variable annuity to the issuing insurance company for processing or five business days from the transmittal date if additional contact with the customer or person associated with the member is necessary in the course of the review], a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity. Subject to the exception in this paragraph, and

treating all transactions as if they have been recommended for purposes of this principal review, a registered principal shall approve the transaction only if the registered principal has determined that there is a reasonable basis to believe that the transaction would be suitable based on the factors delineated in paragraph (b) of this Rule. Notwithstanding the foregoing, a registered principal may authorize the processing of the transaction if the registered principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the registered principal has not approved the transaction, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity. The determinations required by this paragraph shall be documented and signed by the registered principal who reviewed and approved, rejected, or authorized the transaction.

(d) Supervisory Procedures

In addition to the general supervisory and recordkeeping requirements of Rules 3010, 3012, 3013, and 3110, a member must establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in this Rule. The member also must (1) implement surveillance procedures to determine if any of the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable NASD rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.

(e) Training

Members shall develop and document specific training policies or programs reasonably designed to ensure that associated persons who effect and registered principals who review transactions in deferred variable annuities comply with the requirements of this Rule and that they understand the material features of deferred variable annuities, including those described in subparagraph (b)(1)(A)(i) of this Rule.

* * * * *