August 9, 2004

Via E-mail
pubcom@nasd.com

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

Re: Proposed Rule Governing the Purchase, Sale, or Exchange of Deferred Variable Annuities

Dear Ms. Sweeney:

The National Society of Compliance Professionals ("NSCP") appreciates the opportunity to comment on the NASD's proposed new rule to impose specific sales practice standards and supervisory requirements on NASD member firms for transactions in deferred variable annuities.

NSCP

The proposed rule is of considerable interest to the NSCP and its members. The principal purpose of the NSCP is to enhance securities industry compliance, including firms' supervisory efforts and sales practices. An important mission of NSCP is to instill in its members the importance of developing and implementing sound compliance programs across the board.

Since its founding in 1987, NSCP has grown to over 1200 members, and the constituency from which its membership is drawn is unique. NSCP's membership is drawn principally from traditional broker/dealer firms, accounting firms, and consultants that serve them. The vast majority of NSCP members are compliance and legal personnel, and the asset management members of the NSCP span a wide spectrum of firms including employees from the largest brokerage and investment management firms to those operations with only a handful of employees. The diversity of our membership allows NSCP to represent a large variety of perspectives in the asset management industry.

SUMMARY

NSCP shares the NASD's concern about deferred variable annuity sales practice abuses. However, we believe that the goal of investor protection would be better met by increased enforcement of existing rules, regulations, and interpretations, and by improving prospectus disclosure for deferred variable annuities than by enacting the rule as proposed.

We are most concerned about the specific disclosure and documentation requirements proposed. We believe that these are unduly burdensome for broker/dealers.

We believe the proposed rule will create new levels of confusion among broker/dealers, insurance companies, and the many entities that regulate the sale of deferred variable annuities. We are particularly concerned that the proposed disclosure documents, as documents used in the sale of variable annuities, would have to be filed and approved by state insurance regulators. Such approval could take months or, in some jurisdictions, one or more years. We feel also that member firms would require clarification from the SEC as to how such disclosure documents will be treated under the 1933 Act.

We further note that the proposed disclosure requirements are duplicative of requirements currently proposed by the SEC for confirmation and point of sale.[1] These requirements, as proposed, extend to deferred variable annuities because of their unit investment trust structure and underlying mutual fund subaccounts. We believe that development of additional disclosure requirements for variable annuities should be withheld until the proposed SEC rules are finalized.

We believe that, rather than requiring new types of disclosure documents, and by so doing imposing unnecessarily duplicative regulation on firms that distribute deferred variable annuities, the most appropriate means of enhancing disclosure to investors is to require better, plain-English disclosure in the prospectus. We encourage the NASD and SEC to work together to set and achieve this goal.

We are concerned that the proposed rule establishes requirements for documentation, not only for disclosure, but also for transactions and for threefold principal review and approval, that are burdensome and unnecessarily duplicative of existing requirements.

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[1] SEC Proposed Rule: Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Release Nos. 33-8358; 34-49148; IC-26341; File No. S7-06-04.

With regard to principal review, we believe that the proposed one-day time limitation for principal review is highly unreasonable. We propose alternatives that, we believe, will be feasible within existing business, supervisory, and regulatory structures.

We are concerned that the proposed rule implies that variable annuities are *per se* unsuitable for investors with short-to-medium investment time horizons or within tax-qualified plans, positions with which we disagree and which are inconsistent with other NASD authorities.

We are extremely concerned that the proposed rule breaks new ground with regard to requirements imposed on unsolicited transactions. This is both inconsistent with prior NASD and SEC interpretations, and, we believe, an unnecessary and expensive burden to impose on member firms.

We are well aware that many investor concerns and complaints regarding variable annuities stem from overly aggressive allocation of sub-accounts that caused sharp declines in policy values during market declines in the year 2000 and thereafter. However, we feel that these complaints arise not from inherent flaws in the product but from basic suitability and sales practice issues that are already adequately addressed by the body of existing rules, regulations, and interpretations.

These include NASD Rule 2110, 2210, IM-2210-2, Rule 2310, 3010, 3110, SEC Rule 17a-3 and 17a-4, NASD *Notice to Members* 99-35, and the Joint SEC/NASD Report [2] itself. Moreover, as insurance products, variable annuities are also subject to regulation by the insurance regulators in each State. The solution to preventing sales practice abuses is to support compliance with this existing body of authorities rather than to impose upon those who issue, distribute, and sell the variable annuity product a regulatory burden more stringent than that imposed on investments in common stocks or mutual funds. It is worth noting that many of the proposed requirements go far beyond those imposed on types of securities and types of trading generally understood to carry far greater risk than variable annuities.

Finally, we feel that it is important to recognize that deferred variable annuities are valuable products that provide substantial benefits to investors. Policies being sold today differ substantially from those offered in earlier years. Today, many variable annuities are sold with minimal annual fees. Many do not

[2] *Joint SEC/NASD Report on Examination Findings Regarding Broker-Dealer Sales of Variable Insurance Products*, June 2004.

charge any deferred fees upon surrender of the policy. Without additional fees, many policies now provide annual death benefit "step ups" or waiver of surrender fees upon confinement in a hospital or nursing home.

The result is that not only new purchases of deferred variable annuities, but exchanges of older policies into newer policies, may today provide benefits that would not have been possible even five or ten years ago.

It is also important to consider that variable annuities frequently offer investors a "free look" period of, generally, between 10 to 20 days, during which the investor may revoke the purchase. The "free look" concept is virtually without parallel in the universe of securities and investments, and continues to provide a significant means by which the goal of protection of investors in deferred variable annuities may be accomplished.

We recommend substantial modification of the proposed rule.

SPECIFIC COMMENTS

<u>Appropriateness/Suitability</u>

Most current investor concerns and complaints regarding deferred variable annuities stem from aggressive allocation of sub-accounts resulting in sharp declines in policy values during and after the year 2000. We believe that these complaints arise not from inherent flaws in the product, but from basic suitability and sales practice issues that are already adequately addressed by existing rules, regulations, and interpretations.

NASD Rule 2110, 2210, IM-2210-2, Rule 2310, 3010, 3110, SEC Rule 17a-3 and 17a-4, NASD *Notice to Members* 99-35, and the Joint SEC/NASD Report [3] itself fully address the question of suitability of recommendations in deferred variable annuities. Moreover, as insurance products, variable annuities are also subject to regulation by the insurance regulators in each state. The solution to preventing sales practice abuses is to enforce the existing rules aggressively, dramatically improve 1940 Act disclosure, and support compliance with this existing body of authorities rather than to impose upon firms that issue, distribute, and sell the variable annuity product a disproportionate regulatory burden more stringent than that imposed on investments in common stocks or mutual funds, where many similar issues exist.

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[3] *Joint SEC/NASD Report on Examination Findings Regarding Broker-Dealer Sales of Variable Insurance Products*, June 2004.

We feel that it is important to recognize that, while it may be generally true that variable annuities benefit investors with long-term investment objectives, there may be significant exceptions that must not appear from a regulatory, compliance, or arbitration standpoint to be *prima facie* rule violations.

Because they are also insurance policies, variable annuities provide unique financial and estate-planning benefits that may be appropriate for those with short-to medium-term investment horizons. Several examples are listed below:

<u>Example #1</u>: Consider a client who is older (mid 70's), in excellent health, with $300,000 that the client wishes to invest medium term with low risk. The client wishes to have this tax-deferred until such time as the client needs to withdraw the money. Class C fixed-income mutual funds would not meet this need because of the annual tax implications. However, a "C-style" variable annuity with no surrender charge and a bond fund sub-account would.

<u>Example #2</u>: An older client in her mid 70's who does not expect to need the money for herself, but for whom, due to her age, "long-term" investments seem inappropriate. However, if she wishes to continue to invest in the stock market , but provide a death benefit for her heirs, she could do so with an annuity.

<u>Example #3</u>: A client in his late 60's in extremely poor health, who could not qualify for life insurance. A deferred variable annuity with an enhanced death benefit would meet this client's short-term needs.

The examples highlight the fact that variable annuities may not only consider investors' short-term, medium-term, and long-term goals, but also address the *uncertainty* of an investor's time horizon. Accordingly, to restrict variable annuity purchases to investors with long-term horizons would, in effect, withhold the product from those for whom a variable annuity meets objectives across the spectrum of known and unknown time horizons.

For all of the reasons stated above, we recommend deleting (a) Appropriateness/Suitability.

Alternatively, we note that virtually all information needed to fully evaluate an investor's time horizon is included in (a)(2), and therefore incorporated in (a)(1)(C). Accordingly, we suggest deleting (a)(1)(B).

In (a)(1)(C), In order to avoid confusion with regard to the identification of the "associated person recommending the transaction," we suggest that the language in (a)(1)(C) should be consistent with Rule 3110 and reference the "registered representative introducing the account" or the "registered representative of record for the transaction."

Disclosure and Prospectus Delivery

Unsolicited transactions

We believe that application of the proposed rule to unsolicited deferred variable annuity transactions is inappropriate and inconsistent with the position repeatedly articulated by the NASD that broker/dealer responsibility with regard to unsolicited transactions is generally limited.

We note that the National Association of Insurance Commissioners (NAIC)'s recently-adopted model regulation designed to help protect senior consumers when they purchase or exchange annuity products specifically excludes transactions that are not based on a recommendation of the insurer or insurance producer.

We strongly oppose the application of this novel burden on member firms in the proposed rule.

Prospectus delivery

We recommend that the prospectus delivery requirement in (b)(1)(A) should include "to the extent practical," which is the language used in *Notice to Members* 99-35.

Risk disclosure document

We agree that clear, "plain English" disclosure is desirable for deferred variable annuities. However, we believe that the proposed risk disclosure document would impose both a substantial burden and considerable regulatory uncertainty upon broker/dealers involved in variable annuity sales.

Insurers already provide simple English policy summaries in the context of fixed annuities. They have not been provided for variable annuities because the prospectus has always been considered the pre-eminent disclosure document for a security such as a variable annuity. The SEC has, in the recent past, advocated a simplified prospectus or at least a portion of it, to address the very issues which appear to be of concern to the NASD. As discussed below, the SEC currently has a rule proposal outstanding regulating disclosures in regard to fees and costs connected with investment company products, which include variable annuities.

We believe that any additional disclosure requirements should be a part of SEC prospectus regulation.

We are particularly concerned that the NASD's rule proposal calls for disclosure for <u>specific</u> variable annuity contracts, and places the burden for preparation of these documents on the broker/dealer.

This burden is considerable: some firms offer deferred variable annuities from several insurance companies, with significant variations among the policies. The rule as proposed would require such firms to create literally dozens—in some firms, hundreds--of different disclosure documents. Additionally, it is unclear whether the proposal as written would apply to each product in general or to the details of the unique contract purchased by each investor, in which case the broker/dealer would have to generate a unique disclosure document for each customer.

We note also that state insurance departments have highly detailed rules and regulations concerning the sales process for insurance contracts. We are particularly concerned that the proposed disclosure documents, because they would be used in the sale of variable annuities, would, we believe, have to be filed and approved by these regulators. Such approval could take months or, in some jurisdictions, one or more years. We believe that member firms would also require clarification from the SEC as to how such disclosure documents will be treated under the 1933 Act.

We are concerned about liability issues that are likely to arise based on interpretations of the requirements imposed by the rule, such as the materiality of terms and nuances of disclosure language, as well as potential liability for innocent mistakes in the preparation of these documents. Here again, we reiterate our belief that the appropriate vehicle for such disclosure is the prospectus rather than the disclosure documents called for by the proposed rule.

Finally, we believe that the proposed disclosure requirements are duplicative of requirements currently proposed by the SEC for confirmation and point of sale.[4] These requirements, as proposed, extend to deferred variable

[4] SEC Proposed Rule: Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement

annuities because of their unit investment trust structure and underlying mutual fund subaccounts. We believe that development of additional disclosure requirements for variable annuities should be withheld until the proposed SEC rules are finalized.

Accordingly, we recommend that (b)(1)(B) be deleted.

Suggested Alternative

Should the final rule include a requirement for a new disclosure document, we believe that the goal of investor protection would be met by a requirement that the broker/dealer provide a general disclosure document to the customer at or prior to the signing of the application. The disclosure requirement could be prepared by the broker/dealer, by NASD (as is done for margin disclosure and mutual fund breakpoints), by an industry association (we note that the National Association of Insurance Commissioners [NAIC] has a model regulation, which many states have adopted, requiring easy-to-read summaries for fixed annuities), or by providing a copy of the variable annuity disclosure on the SEC website: "Variable Annuities: What You Should Know."[5]

If the NASD and SEC determine that a specific disclosure document for each unique deferred variable annuity product must be provided, the burden for preparation of such documents must be placed on the insurance companies issuing the variable annuities rather than on the broker/dealer distributors. Member firms would then be required to provide the specific disclosure documents to their customers.

Exchanges and replacements

We agree that due diligence is essential in recommending the exchange of a deferred variable annuity into a new contract.

However, we reiterate our concern that application of a disclosure requirement to unsolicited deferred variable annuity transactions is inappropriate and inconsistent with prior interpretation by the SEC and NASD. As such, it represents a novel doctrine with widespread, significant implications for all securities transactions.

As discussed above, we are concerned about the additional regulatory

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Amendments, and Amendments to the Registration Form for Mutual Funds, Release Nos. 33-8358; 34-49148; IC-26341; File No. S7-06-04.

[5] Www.sec.gov/investor/pubs/varannty.htm

burden imposed by additional disclosure documents.

We agree that it is essential for a registered representative to have sufficient knowledge of an existing contract to ensure that a recommendation to exchange into a new policy is in the customer's best interest.

However, in order to provide disclosure as specific as proposed, it would be essential for the representative to have a copy of the existing policy before implementing the exchange. Yet it is frequently impossible to obtain a copy of the old policy, since insurance companies issuing variable annuities will not, for both business and confidentiality reasons, provide them to anyone other than the representative of record.

We believe that it is important to recognize that there are many situations in which a representative is able to make a recommendation without having the actual contract in hand. Here, it is important to remember the dramatic recent changes in variable annuity products. Today, many variable annuities are sold with minimal annual fees. Many do not charge any deferred fees upon surrender of the policy. Without additional fees, many policies now provide annual death benefit "step ups" or waiver of surrender fees upon confinement in a hospital or nursing home. The result is that many exchanges of older policies into newer policies, may today provide benefits that would not have been possible even five or ten years ago.

Registered representatives may recognize facts specific to their customers that make an exchange beneficial. For example, a customer previously indifferent to the lack of a nursing-home exemption benefit in an older policy may find such a benefit in a new policy to be highly desirable. Moreover, many representatives have sufficient knowledge of a given insurer's older variable annuity products to make an informed recommendation for an exchange, such as replacing a policy known to provide no death benefit with a policy that provides a stepped-up death benefit for no additional fee. Other concerns, such as concern about an insurance company's financial stability, may give rise to a recommendation for an exchange.

Finally, under existing rules, regulations, and interpretations, registered representatives clearly already have a duty to have a reasonable basis for their recommendations. We believe that this existing requirement is sufficient to cover exchanges of variable annuities, just as it clearly covers transactions in mutual funds and other securities.

For all of the reasons stated above, we believe that (b)(2)(A should be deleted.

Should the proposed (b)(2)(A) requirement stand, we believe that it is important to clarify what is considered significant, particularly so that member firms could take advantage of the exemption in the proposed rule if the firm uses an existing exchange or replacement form authorized by a state insurance commission or other regulatory agency. In other words, in order to make the determination as to whether "the regulatory agency's form requires disclosure of the information required by this Rule," it is necessary that the rule be sufficiently specific so that the determination can be made.

In order to avoid this problem, we recommend that the (b)(2)(A) disclosure requirement be made more general, as follows:

"A summary of the reasons for recommending the exchange."

With regard to (b)(2)(D), we agree that an internal exchange of an existing contract may, at times, be beneficial for a customer, and should be considered where possible. However, we are concerned that the proposal suggests that broker/dealers may be considered to be required to determine whether modification or internal exchange of an existing contract is feasible. In cases where the existing contract was issued by a non-affiliated insurance company, the broker/dealer would have no ability to obtain any information about the existing contract from the original issuer, including whether a beneficial internal exchange might be offered.

It would be impossible for member firms to comply with a requirement that mandates review of the possibility of an internal exchange without a parallel requirement that insurers must provide this information to member firms upon request. We believe that, without regulatory imperatives to the insurers, this is virtually impossible because of both confidentiality and competitive concerns.

However, recognizing the intent of this clause, which is to help make investors aware of their options with regard to upgrading existing contracts, we propose that a general disclosure document suggest that a <u>customer</u>, prior to exchanging an existing contract, may wish to contact his or her insurance company in order to determine whether an internal exchange may be possible.

Accordingly, we suggest modifying the language of (b)(2)(D) to read:

"That the customer may wish to consider the possibility, if any, of requesting that the insurance company that issued the existing contract modify, adjust, or internally exchange it to meet the customer's objectives rather than exchanging or replacing the contract."

A member or person associated with a member may use an existing exchange or replacement form authorized by a state insurance commission or other regulatory agency to satisfy the disclosure requirements of this paragraph to the extent that the regulatory agency's form requires disclosure of the information required by this Rule. If the regulatory agency does not require disclosure of all of the information required by this Rule, a member or person associated with a member may create and use an addendum to the regulatory agency's form.

As noted above, in order to utilize the regulatory agency form exemption, the rule must be more specific with regard to what is considered "significant" in (b)(2)(A), above.

Principal Review

We believe that (c) Principal Review and (d) Supervisory Procedures substantially duplicate each other. Accordingly, we recommend that (d) be deleted and that (c) be changed as follows:

"In addition to the general supervisory and recordkeeping requirements of Rules 3010 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. In particular, the member must implement procedures to screen for and require a registered principal's review of all transactions in deferred variable annuities."

One-day requirement

We believe that many member firms would find it virtually impossible to comply with a one-day approval requirement.

It is important to remember that, in the vast majority of cases, variable annuity applications are still executed in paper, not electronically. Many variable annuity customers and producers are located in locations remote from member firms' business processing areas. Many representatives are in locations that do not have overnight air service without considerable difficulty. The alternate methodology would be utilization of fax or other electronic means, which may be technically feasible but which present problems of legibility, conversion to technological environments that many firms have not embraced, and susceptibility to technological breakdowns of equipment

The practical effect of the imposition of a one-day principal review and signature requirement would be to disenfranchise numerous consumers who happen to be located geographically distant from the firm's reviewing principals. Conveying the written applications for review within 24 hours plus executing the review itself would be an excessive administrative burden.

As noted in the Joint SEC/NASD Report , [6] "We note that while a particular sound practice may work well for a large firm, the same approach may not be effective or economically feasible for a smaller firm. The reverse is also true. Firms must adopt procedures and controls that are effective given their size, structure and operations."

We note also that the Joint SEC/NASD Report does not support the one-day principal review proposal. It neither specifically addresses nor makes recommendations regarding the timeliness of supervisory review, identifying only as sound practice the establishment by the firms of comprehensive written supervisory procedures governing the review of variable annuity transactions.

We further note that Rule 2820 (d), Variable Contracts of an Insurance Company/Transmittal, requires that "Every member who receives applications and/or purchase payments for variable contracts shall transmit promptly to the issuer all such applications and at least that portion of the purchase payment required to be credited to the contract."

Accordingly, as an alternative to the one-day requirement, we suggest that the time period for principal review be *"promptly,"* consistent with 2820(d).

We feel that this language is consistent with existent regulation, is understood by member firms, conveys the appropriate message, and avoids confusion as to the specific event that triggers the requirement.

Moreover, even if principal review did not occur on the next day or even within several days of the application signature, the consumer may have a "free look" period, usually ten to fifteen days from the customer's receipt of the contract, to return the contract for a refund of premium. Few, if any, other types

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[6] *Joint SEC/NASD Report on Examination Findings Regarding Broker-Dealer Sales of Variable Insurance Products,* June 2004.

of securities offer this kind of liberal opportunity to rescind a transaction. With the modification we suggest, the NASD's purpose of a principal review is still served, the consumer is not disadvantaged, and current business structures can still function reasonably.

Standards of review

We agree that the factors listed in (c)(1)(A) and (c)(1)(B) should be considered as part of a suitability determination for deferred variable annuities. However, we are concerned that the proposed language suggests that, where certain factors are present, a deferred variable annuity is *prima facie* unsuitable.

Accordingly, we recommend that (c)(1)A) and (c)(1)(B) be deleted and replaced by the language, *"…the customer's age, liquidity needs, investment objectives, risk tolerance, tax status, financial situation, or any other relevant factors make the transaction unsuitable."*

We are concerned that (c)(1)(D) imposes upon the member firm a duty to obtain information that may be impossible for it to obtain. We feel that it is unrealistic to impose such a requirement given that the registered representative and broker/dealer might have no knowledge of prior exchanges or replacements by the customer.

We further note that this suggested element of review goes far beyond the sound practices and relevant exception reporting identified by the Joint SEC/NASD Report.

Accordingly, we recommend that (c)(1)(D) be deleted. Alternatively, the language could specify "….a customer whose account *at the member firm*…."

Deferred variable annuities within tax-qualified plans

We appreciate the need for diligence with regard to the purchase of deferred variable annuities within qualified plans, in order to ensure that the security can be reasonably expected to provide benefits to the customer over and above tax deferral.

However, we believe that it is important to consider that customers can and do embrace in variable annuities many benefits that may not be available in any other investments in qualified plans, both with or without additional charges, such as

- death benefit
- asset protection from creditors
- earnings enhancement benefit
- “living” principal protection
- cost-free annuitization
- annuitization based on mortality tables fixed at time of purchase.

Previously, the NASD has taken the position that variable annuities may be suitable in tax-qualified retirement plans and accounts “when other benefits of a variable annuity such as a death benefit or annuity payout options support the purchase.”[7]

We note that in the NASD’s new online training course in variable annuities, [8] there is a discussion of appropriate situations for the recommendation of variable annuities within qualified accounts, which includes:

“If all variable annuity features and costs have been explained to the customer and the customer determines that the variable annuity will satisfy specific needs other than tax deferral, such as a death benefit, living riders, fixed fees, guarantees of annuity income for life or a stated period of time, etc., it may be appropriate to recommend a portion of the funds in a qualified account be allocated to a variable annuity.”

We suggest that the language in (c)(1)(F) be modified as follows: *“the purchase of a deferred variable annuity in a tax-qualified retirement account provides benefits over and above tax deferral.”*

We believe that this language, in the context of the other suggested modifications of section (c), which incorporate knowledge of the customer’s tax situation and ability to understand the investment, is sufficient to ensure diligence with regard to review of variable deferred annuity purchases within qualified plans.

We agree that “Standards established by the member must be reasonably designed to ensure that transactions in deferred variable annuities are appropriately supervised,” with the exception, as stated above, that the supervisory standards should not apply to unsolicited transactions.

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[7] “NASD Fines American Express Financial Advisors $350,000 For Improper Sales of Variable Annuities and Life Insurance,” News Release December 4, 2002.
[8] E-Learning Course: Variables Annuities II: Understanding Professional Responsibility and Ethical Sales Practices,” available at www.nasdr.com/variable_annuities.asp

If unsolicited transactions are excluded from the proposed rule, then (c)(2) becomes moot.

We note that the signature requirement in (c)(2) is in addition to the other principal review requirements. This seems to be unnecessarily duplicative.

Our concerns, expressed above, with regard to a requirement of one-day review also apply to this section.

We note that the signature requirement in (c)(3) is expressly in addition to the other principal review requirements. We believe this to be unnecessarily duplicative, particularly in light of our belief that no other type of security or trading strategy requires a three-part principal review process.

We also note that (c)(3) duplicates the principal review requirement in (c)(1)(C) above.

Our concerns, expressed above, with regard to a requirement of one-day review also apply to this section.

Our concerns, expressed above, with regard to unsolicited transactions also apply to this section.

Supervisory Procedures

We believe that (c) Principal Review and (d) Supervisory Procedures are substantially duplicative. Accordingly, we recommend that (d) be deleted and replaced by language in (c) that requires the firm to establish procedures for principal review.

However, should the proposed rule retain both sections, we make suggestions for supervisory procedures below.

We agree that an affirmative suitability determination is appropriate for variable annuities. However, we believe that variable annuities can be appropriate for certain short-term situations, including those of older customers.

For example, an older customer in poor health may wish to exchange an older policy that provides no “stepped up” death benefit, and for which the surrender charge period has ended, into a policy with similar, or even lower annual fees that provides a death benefit. The exchange permits the customer to lock in gains in the existing policy as a death benefit.

We believe that the phrase beginning "..such as" is unnecessarily duplicative of the general suitability determination and should be deleted.

We suggest that the (d)(1) should read: "A deferred variable annuity investment for a customer whose age or liquidity needs may make such an investment inappropriate, or with a *specific* short-term investment objective *that may make the investment unsuitable*."

As expressed above, we are concerned that (d)(1) imposes upon the member firm a duty to obtain information that may be impossible for it to obtain.

Accordingly, we recommend that (d)(1) be deleted. Alternatively, the language could specify "….a customer whose account *at the member firm*…."

<u>Training</u>

We agree that there is a need for adequate training of both registered representatives and registered principals with regard to variable annuities. However, we feel that the requirement that firms establish additional specific training policies or programs over and beyond those that may be part of the Continuing Education Program is unnecessarily burdensome.

We note that current examination and registration requirements include variable products in the Series 7 and appropriate principal examinations. Moreover, registered personnel with insurance licenses have already completed substantial training in insurance products over and above their Series 7 training.

Here again, the proposed requirements for variable annuities goes beyond requirements for transactions in securities that may carry considerably greater risk, such as uncovered options, "penny stocks," short selling, or margin trading.

We therefore suggest modifying (e) as follows:

> *"Members whose business includes the sale of deferred variable annuities shall ensure that their training plan and Firm Element of their Continuing Education Program includes material sufficient to ensure that associated persons who effect and registered principals who review transactions in deferred variable annuities have sufficient knowledge of the material features of deferred variable annuities to comply with the requirements of*

this Rule. "

ADDITIONAL COMMENTS

<u>Group contracts</u>

The proposed rule does not distinguish between individual annuity contracts and those offered under group variable contracts. In the latter case, many group variable annuities are offered within qualified pension plans such as 401k, 403b, and 457 plans.

As a group variable annuity, the SEC has recognized such products to be exempt[9] from many of the standard SEC requirements due to the fact that such plans are typically sponsored by an employer or employer benefit plan which is the client, and the employees' contributions are typically a small percentage of salary for the purposes of establishing a retirement fund with lifetime benefits. Such plans are also frequently covered by ERISA.

We believe that such plans and group contracts fall outside of the area of high concern and should be specifically excluded from the scope of this proposed regulation except in cases where variable annuities are individually sold to employees. This would follow the pattern established by the National Association of Insurance Commissioners in their recently promulgated Senior Protection model regulation.

We would specifically exclude the contracts used to fund: (1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA); (2) A plan described by Sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer; (3) A government or church plan defined in Section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the IRC; (4) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor; (5) Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or (6) Formal prepaid funeral contracts.

CONCLUSION

[9] Securities Act of 1933, Section 3(a)(2)

NSCP shares the NASD's concern about deferred variable annuity sales practice abuses. However, we are strongly opposed to the rule as proposed.

Suitability

We are well aware that most investor concerns and complaints regarding variable annuities stem from aggressive allocation of sub-accounts during the recent "tech wreck." We feel that the issue here is one of basic suitability in the underlying equity investments, not inherent flaws in the variable annuity product.

We believe that such suitability questions are best addressed within the existing rules, regulations, and interpretations that guide member firm compliance.

Disclosure

The proposed disclosure document will create burdensome filing and approval requirements of member firms by the state insurance companies that regulate their sales of variable annuities.

We support the goal of better, plain-English disclosure, but believe that most appropriate means of enhancing investor protection is to require of issuers better disclosure in the prospectus. Alternatively, specific disclosure documents should be required of insurance companies, not member firms.

We believe that the proposed disclosure requirements are duplicative of requirements currently proposed by the SEC for confirmation and point of sale.[10] We believe that development of additional disclosure requirements for variable annuities should be withheld until the proposed SEC rules are finalized.

Unsolicited transactions

We are extremely concerned that the proposed rule breaks new ground with regard to requirements imposed on unsolicited transactions.

Principal review

[10] SEC Proposed Rule: Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Release Nos. 33-8358; 34-49148; IC-26341; File No. S7-06-04.

We believe that firms should be required to establish procedures that require principal review of transactions in variable annuities. We oppose specific, detailed requirements for principal review, particularly the proposed one-day time limitation and three-part approval process.

Supervisory procedures

We believe that this unnecessarily duplicates the proposed principal review requirements and should be deleted.

Training

We believe that the appropriate vehicle for enhancing training in variable annuities is the Firm Element of the Continuing Education Program.

We hope that these comments are useful in the NASD's consideration of the proposed rule. We would be pleased to discuss our views in more detail at any time.

Very truly yours,

Joan Hinchman
Executive Director, President and CEO

The National Society of Compliance Professionals, Inc.
22 Kent Road
Cornwall Bridge, CT 06754
Phone: 860-672-0843, Fax: 860-672-3005
Email: jhinchman@nscp.org