By Electronic Mail

August 6, 2004

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

Re: Comments on Notice to Members 04-45
Proposed Rule Governing the Purchase, Sale or Exchange Of Deferred Variable Annuities

Dear Ms. Sweeney:

Thank you for giving us the opportunity to comment on the above-referenced rule proposal (the "Proposal").

At the outset we would like to state our agreement with the general concept of enhanced disclosure for investors purchasing deferred variable annuities. Those products are complex and finding a manner in which investors can understand variable annuities more fully is an important goal. We also agree that professionals selling these products need to be diligent in ensuring that the products are appropriate for investors.

However, as set forth more fully below, the Proposal has a number of substantial and serious drawbacks. The Proposal has provisions that are unworkable and could cause confusion to the investing public and the industry. The Proposal would impose substantial costs and potential civil and regulatory liabilities on broker-dealers that are not warranted. Lastly, there are substantial legal issues which much be addressed before any such Proposal could be adopted.

The Proposed Disclosure Document is Unworkable

The Proposed Rule would require each individual broker-dealer to prepare a separate "plain English" risk disclosure document highlighting the "main features" of the "particular variable annuity transaction." It is respectfully submitted that such a requirement would cause unwarranted additional risks and costs to the broker-dealers and potentially create confusion for investors.

At the outset, we are concerned with the prospective treatment of the proposed disclosure document under federal securities laws. Notwithstanding the fact that the Proposal requires a prospectus to be delivered with the proposed disclosure document, it is not clear that the disclosure document would not be deemed to be an additional prospectus. In this regard, we note that the SEC, in 1998, adopted Rule 498 under the Securities Act of 1933 ("Securities Act") relating to "profile prospectuses" for mutual funds.[1] Rule 498 has many similarities to the NASD's current Proposal in its attempt to provide for "plain English" disclosures to customers. However, there are significant differences in that Rule from the current Proposal. First, the SEC exercised its authority under 10(b) of the Securities Act which allowed for an exemption from Section 11 strict liability. The NASD has no such apparent authority. Second, Rule 498 requires specific information to be presented in a specified format. The NASD Proposal does not provide for such consistency. Third, Rule 498 requires the profile prospectus to be filed with the SEC. There is no such requirement in the NASD Proposal. Fourth, the SEC rules exclude from the definition of "advertising" under the Investment Company Act of 1940 any prospectus, and makes clear that the Rule 498 profile prospectus is included in this exemption. There is no similar provision in the NASD Proposal.[2] Lastly, and most importantly, the SEC rules provide for the issuer to prepare and deliver the profile, not the retail broker-dealer. This makes sense and provides for a single disclosure document for a particular product for all investors.

In addition to federal securities laws considerations, state-by-state insurance laws must be considered. Those state laws dealing with filing and prior approval by insurance regulators must be analyzed and the impact on brochure development, delivery and the sales processes assessed.

Even were the federal and state law issues to be adequately considered and somehow addressed, there are other significant and unwarranted potential liabilities to broker-dealers arising from the proposed disclosure document. In its current form, the Proposal would result in each broker-dealer constructing its own disclosure document about the same annuity. Certainly, no two broker-dealers' disclosure document would be the same. Each broker-dealer would deem certain features of a particular product to be of differing importance. Thus, an investor who consults with more than one broker-dealer on a particular product would receive different disclosure documents for the same product. This could potentially undermine the entire purpose of the prospectus to define uniform disclosures to investors and create confusion.[3]

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[1] In adopting Rule 498, the SEC specifically refused to apply the rule to variable annuities until such time as the impact of Rule 498 could be assessed. *See Release No. 7513 (March 13, 1998).*

[2] It is not clear in the Proposal whether the proposed disclosure statement would be subject to NASD advertising rules and review.

[3] This problem is exacerbated by the language in the Proposed Rule that suggests that the disclosure document must disclose information concerning the particular annuity "transaction." This suggests that any disclosure document must be specific to an individual customer, although the Proposal otherwise suggests that it is product-specific. This language should be clarified.

It should also be noted that the Proposal calls for use of the risk disclosure document for "sales." This does not make sense, particularly in view of the disclosure required.

The risk to the broker-dealers of class action and other lawsuits stemming from these differences are great. Plaintiffs in any lawsuit would need only to gather different disclosure documents from different broker-dealers relating to the variable annuity sold by the defendant/respondent broker-dealer. The differences in those brochures would create new grounds for civil liability where the trier of fact determines to prefer the disclosure of one brochure over another, usually long after a sale occurred. Even where the actual disclosures are similar, the placement of one disclosure in the document over another would be fodder for plaintiff's counsel.

Lastly, the costs to the broker-dealer would be huge. In this regard, our broker-dealers have selling agreements with over 50 variable annuity issuers. Issuers may have four or more different variable products. In some instances, variable annuity manufacturers offer customers the ability to further tailor the product with various options and riders, many of which affect the product's costs. This would require our broker-dealers to maintain an inventory of potentially hundreds of disclosure documents. The costs of production and maintenance of these documents and the additional personnel required to monitor their updating and usage simply cannot be absorbed by smaller broker-dealers with the current compensation structure of these products.

It is submitted that, given the above, any risk disclosure document must be prepared by the product's issuer and not by the retail broker-dealers. We request that the NASD work with the SEC, whose authority in this area is clear, to provide investors with profile prospectuses similar to those for mutual funds,[4] and not unilaterally exercise its authority over broker-dealers and expose those broker-dealers to unwarranted risk and expense.

The Proposed Suitability Standards are Confusing and Unwarranted

The Proposal would require a front-line salesperson to make specific suitability determinations where the transaction is recommended. It is not clear why the NASD is proposing a specific suitability rule for these products when Rule 2310 already addresses the suitability requirement for all products. Creation of differing requirements of gathering customer information for differing products will result in confusion in the industry.[5]

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[4] In NTM 04-45, the NASD requested comment on whether a disclosure document could be developed for all variable annuities rather than on product-specific information. We believe that such a document would be difficult to produce given the variety of products available and would have many of the same difficulties discussed above. If such a document is deemed necessary, we urge the NASD to work with the SEC and state insurance agencies and industry representatives to create an industry-wide educational brochure.

[5] It is not clear how Rule 2310 is impacted by the Proposal's variable annuity suitability considerations. Further, the Proposal uses an "appropriate" standard, instead of the "reasonable basis" standard of Rule 2310. Clarification of this language is necessary.

In the case of principal review for suitability, the Proposal requires differing standards for whether the transaction has been recommended. Where the transaction has been recommended, the front-line salesperson has the affirmative duty to determine suitability and the principal is required to review the underlying supporting documentation. Where the transaction has not been recommended, the reviewing principal appears to be responsible for the initial suitability determination for the transaction. This is confusing.

Further, current NASD rules do not require suitability determination for unsolicited transactions for any other products, including those that are similarly complex as variable annuities. Creation of a new suitability standard for unsolicited variable annuity transactions is not warranted.

The One Business Day Review Requirement is Arbitrary and Unworkable

The Proposal requires a somewhat artificial turn-around time for principal review of a variable annuity transaction of one business day from the time the customer has executed the application. This proposed requirement is unnecessary and administratively unworkable. In some instances, the designated principal responsible for the review of the transaction may not be available for any number of reasons. In other instances, further information may be needed before the principal can sign off on the transaction. The additional information may not be able to be gathered in a single day where the representative and/or the customer are not available.

The Proposal makes no provision for these events and it is not clear what the ramifications are for failure to approve a transaction within the one-day period. If the transaction is to be considered void and new paperwork required, the benefit to the investing public is questionable. If the broker-dealer is to be held liable for its inability in a given transaction to properly gather necessary information for adequate review within the arbitrary time period, the result is unfair.[6]

Further, notwithstanding today's electronic environment, there are representatives in some offices that continue to use regular mail for processing transactions. Mail is not typically delivered in a single day. Use of overnight delivery services in these circumstances would result in unnecessary and burdensome costs to the broker-dealers.

The Proposal sets forth no public-interest justification for the proposed time period in view of the difficulties presented.

[6] We note that the Proposal requires the risk disclosure document to "inform the customer that all applications to purchase or exchange a deferred variable annuity are accepted subject to review and approval by a designated registered principal." This language does not address the problem noted above. Further, the language suggests that the transaction has been approved when in fact it is subject to rejection by the broker-dealer and by the issuer upon their review. Clarification is necessary.

The Supervisory Procedures Requirements are Unclear

The Proposal would require broker-dealers to establish written supervisory procedures setting specific standards for principal review of sales of variable annuities. The procedures would require specifying a customer's age, "long-term investment" objectives and percentage of net worth as triggering events. Nevertheless, there is no guidance by the NASD as to what these figures should be. Certainly, if the NASD believes these factors to be worthy of specific standards, it should be willing to provide those standards in an effort to reach uniformity in the industry.

We believe that before setting such vague standards, the NASD should work together with the SEC, state regulators and industry members to establish more concrete guidelines.

Conclusion

While we appreciate the NASD's concerns over sales of variable annuities, it is respectfully submitted that the Proposal as currently drafted is largely unworkable and results in substantial and unfair risks and liabilities to broker-dealers. The Proposal would create significant costs that the investing public must ultimately bear. We are concerned with the growing number of regulatory proposals that place the burden on retail broker-dealers, particularly small broker-dealers such as ours, to make disclosures to investors in addition to those in a prospectus.

We urge the NASD to work with securities and insurance industry professionals and other regulatory bodies to address its concerns in a manner that considers all applicable laws and provides for greater consistency.

Respectfully submitted,

Karl Lindberg, ChFC
President & CEO
ING Financial Partners