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Via E-Mail
Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, N.W.
Washington, D.C. 20006-1500

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

Dear Ms. Sweeney:

Nationwide Financial Services, Inc. (the "Company")[1] appreciates the opportunity to submit its comments concerning the proposed rule (the "Proposed Rule") set forth by the NASD in the above-referenced Notice to Members.[2]

Introduction

While the Company strongly supports the NASD's efforts to ensure that sales of deferred variable annuities are being undertaken in a manner that is consistent with the ethical standards set forth in the NASD's rules, including the requirement to deal fairly with the public, we must question the need for this regulatory proposal, given the existing regulatory safeguards that are in place, including but not limited to:

- adequate suitability and supervisory standards, as set forth in the NASD's Conduct Rules;
- comprehensive disclosure standards for variable annuity issuers set forth in Form N-4, a form that was recently reviewed by the Securities and

[1] The Company is submitting this comment letter on behalf of (i) its broker-dealer affiliates, each of which is an NASD member firm that is authorized, pursuant to Selling Agreements with variable annuity issuers, to sell deferred variable annuities and (ii) its affiliated life insurance companies that issue such annuities.

[2] Notice to Members 04-45 (June 2004).

Exchange Commission (the "SEC") and revised to promote greater understanding on the part of prospective purchasers through "plain English" disclosures; and

- state-mandated replacement forms, which require detailed disclosures pertaining to variable annuity exchanges and replacements.

To the extent the Proposed Rule imposes an additional layer of regulatory requirements for deferred variable annuities that would not be applicable to sales of other types of securities, we question whether any incremental benefits can be expected to ensue and believe that such requirements would be significantly and unnecessarily duplicative, given the regulatory safeguards described above and the complaint history regarding variable annuities, as outlined by the American Council for Life Insurers ("ACLI") in its comment letter to the NASD.[3]

If, however, the NASD staff chooses to proceed by presenting the Proposed Rule to the SEC for adoption, the Company recommends several modifications and clarifications, which are more particularly described below.

General Issues

The Proposed Rule should be clarified by indicating that it has no applicability to sales of deferred variable annuities to institutional customers. This would include those instances in which variable annuities are used as the funding vehicle for qualified retirement plans. The Proposed Rule's requirements relating to suitability determinations, principal review and disclosure are only relevant in the context of direct dealings by member firms with individual investors.

The Proposed Rule should also be clarified by indicating that it does not apply in the case of (i) additional investments that are made following the purchase of a deferred variable annuity and (ii) asset transfers between and among underlying investment portfolios. Application of the disclosure requirements contained in the Proposed Rule to such additional investments and transfers would serve no useful purpose and would create a large administrative and cost burden on product issuers and broker-dealers.

[3] In its comment letter, the ACLI noted that unsuitable annuity sales account for only .0032 of the NASD's total disciplinary actions on average over the past five years. To provide perspective, the ACLI indicated that there were 19,562,666 individual variable annuity contracts in 2000. The ACLI further noted that the SEC logged 14 times as many equity security complaints as variable annuities and 4.5 as many mutual fund complaints as variable annuities for the 12 months ending May 31, 2004.

We have serious concerns regarding the timing of certain activities that are required under the Proposed Rule. We recommend that the NASD staff revisit the Proposed Rule with a view toward ensuring that all required activities are subject to timeframes that are consistent with applicable laws, rules and regulations and are commercially reasonable based upon how variable annuity business is transacted in the marketplace.

Appropriateness/Suitability

Section (a) (1) of the Proposed Rule describes determinations that should be made by associated persons as a prerequisite for making recommendations for the purchase, sale or exchange of these products. Item (B) refers to a determination that the customer has a "long-term investment objective." We believe that a more appropriate reference in this instance would be a determination that the product that is being recommended is compatible with the customer's investment objectives. Section (a) (1) also requires that these determinations be documented and signed by the associated person making the recommendation. We believe that a signature requirement under these circumstances would create an unnecessary additional step in this process. If the associated person has documented his or her determinations in writing in support of a recommendation and has submitted the transaction to the appropriate registered principal, such steps should be viewed as a sufficient attestation on the part of the associated person that he or she has a sound basis for recommending the transaction and submitting it for principal review.

Disclosure and Prospectus Delivery

Federal securities law addresses the timeframe during which prospectuses must be delivered. The Proposed Rule purports to impose a standard for the delivery of deferred variable annuity prospectuses that is inconsistent with such law. We believe that this is improper and therefore recommend that the NASD remove its reference to the delivery of a current prospectus in section (b) (1) of the Proposed Rule.

The separate risk disclosure document referenced in section (b) (1) should not be the responsibility of broker-dealers offering variable annuities. Issuers of securities, including but not limited to those issuing variable annuities, are clearly best suited to ensure that proper disclosures regarding their products are being accurately and consistently provided to prospective purchasers. In the case of variable annuities, it is not uncommon for major insurance carriers to have selling agreements with several hundred broker-dealers authorizing those broker-

dealers to sell the carrier's variable annuity contracts. Since selling agreements typically preclude the broker-dealer from creating and using sales literature without the express approval of the issuer, broker-dealer firms would be required to create, update and maintain these risk disclosure documents and obtain approval of the creation and modification of such documents from every single issuer with whom they have a selling agreement. It is simply not plausible to place responsibility on broker-dealers to create disclosure documents that describe these securities products.

While we strongly believe that broker-dealers should not be creating disclosure documents, as noted above, we also believe that the existing SEC form (Form N-4), prescribed for use by variable annuity issuers, is more than sufficient from the standpoint of providing investors with necessary information regarding product features, risks and fees, expenses and other charges. Thus, we question the need for additional disclosure requirements. In that regard, we respectfully suggest that the NASD and the SEC consider the potentially counterproductive impact that such requirements would have in light of all of the disclosure-related regulatory proposals that are currently under consideration.[4]

In the case of an exchange or replacement of a deferred variable annuity, section (b) (2) of the Proposed Rule would require the provision of certain information in writing, regardless of whether the transaction has been recommended. We must question whether this requirement is necessary, given state replacement regulations (which require detailed disclosures on prescribed forms) that are designed to address abusive replacement activity. In addition, we believe that the proposed requirement presents practical difficulties in terms of access to the comparison information that would be needed in order to be in compliance. This is particularly true in those instances in which the sales representative has not contemplated or is not making a recommendation. In that regard, there could be many instances in which a broker-dealer would not be able to obtain all of the necessary information regarding the existing contract. Yet, the Proposed Rule makes no allowance for this possibility. The Company recommends that the NASD staff revisit section (b) (2) and, to the extent it

[4] The National Association for Variable Annuities has indicated in its comment letter that, considering all of the pending rule proposals together, as well as existing state requirements, a potential purchaser of a variable annuity could possibly receive the following mandatory disclosure documents: (i) a summary of revenue sharing and differential compensation arrangements paid to the selling broker-dealer, (ii) a point-of-sale disclosure of expected sales loads and fees, revenue sharing and special compensation, (iii) a current variable annuity prospectus, (iv) a separate risk disclosure document and (v) state-required disclosure forms, including exchange forms.

unnecessarily duplicates requirements under existing state laws and regulations, consider eliminating it.

Principal Review

The Company recommends that the principal review process required under section (c) of the Proposed Rule be triggered by completed transactions, as opposed to the "date of execution of the deferred variable annuity application." The Company further recommends that the time frame proposed for such review (i.e., no later than one business day following the date of execution of the……application) be eliminated and replaced with a reasonableness standard. Given the various ways in which variable annuity business is transacted, including those instances in which sales representatives and their supervisory principals are physically located in two different states, the "one business day" standard is not plausible. In addition, final principal approval should occur only after it is determined that all application forms and related documents are in "good order."

Section (c) (1) sets forth separate considerations to be taken into account in connection with the principal review process. We have the following comments regarding such considerations:

- In Items (A) and (B), the parenthetical reference to "standard established by the member" should be removed. In the case of maximum age, the issuer establishes this, based on actuarial concerns.
- The reference to a customer's net worth in Item (B) is a concern, given the need to take into account the customer's entire financial circumstances, including estate planning goals, when determining suitability.
- Items (C) and (D) are a concern, given the limitations upon what a member firm can learn about replacement history, notwithstanding a diligent search. Perhaps Items (C) and (D) can be modified to reflect that these considerations are subject to such information that can be reasonably ascertained based upon a diligent review of available replacement history. In addition, the reference to "the associated person effecting the transaction" in Item (E) is problematic since the customer/contract purchaser is really the person effecting the transaction.
- Item (F) should be eliminated. Since a deferred variable annuity may or may not be suitable for inclusion within a particular tax-qualified retirement account, we fail to see the need for a specific reference to tax-qualified retirement accounts in this section of the Proposed Rule.

Supervisory Procedures

We recommend that conforming changes be made to this section based upon changes that we have recommended to all preceding sections.

Conclusion

The Company acknowledges the importance of ensuring that variable annuity sales are suitable and strongly opposes abusive sales practices with respect to such products. Notwithstanding the foregoing, however, we do not believe that the Proposed Rule is needed, given the existing regulatory regime. That regime includes (i) Conduct Rules that prescribe steps that must be taken in order to ensure that sales personnel have a sound basis for recommending a transaction, (ii) Conduct Rules that require detailed written supervisory procedures, including the review of transactions on the part of qualified supervisory principals, (iii) SEC-mandated disclosure standards for variable annuity issuers that were recently revised to promote greater understanding on the part of the reader and (iv) state-mandated forms containing extensive disclosure requirements for use in connection with exchanges and replacements.

We appreciate your consideration of our comments. Please let us know if we can provide any further assistance. If you have any questions, please contact the undersigned at (614) 677-2406.

Very truly yours,

Kevin S. Crossett
Vice President – Associate General Counsel