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August 9, 2004

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

**Re: NASD Notice to Members 04-45 relating to Deferred Variable Annuity Sales
Practices**

Dear Ms. Sweeney:

Raymond James Financial Services, Inc.¹ (RJFS) appreciates the opportunity provided by the NASD to comment on the proposed rule governing the purchase, sale or exchange of deferred variable annuities as described in Notice to Members 04-45. Prior to implementing broad-based and important rules such as those proposed in NTM 04-45, it is critical for the NASD to receive feedback from its member firms so that the views of those who have day-to-day experience with the securities business are understood.

General Comments

In principle, RJFS supports the NASD's goal of providing clear and understandable information regarding variable annuities to investors so that they can make informed investment decisions. Due to the numerous variations of variable annuities, it is imperative that broker-dealers and their financial advisors explain as clearly as possible the important features of the variable product being considered so that clients may effectively evaluate whether the product meets their needs. Further, RJFS agrees that variable annuities should be evaluated by registered representatives to determine whether they are suitable for their clients and should document their reviews. Finally, RJFS also agrees with the NASD that principals should review variable annuity transactions prior to the contract effective date. All of these steps should help reduce customer confusion and the potential for unsuitable sales of variable products.

¹ Founded in 1974, Raymond James Financial Services, Inc. (RJFS) has more than 3,900 Financial Advisors in more than 2,100 offices nationwide. RJFS offers general securities, such as individual stocks and bonds, and professionally managed investment alternatives primarily using an asset allocation and/or financial planning methodology. A member of the NASD, RJFS provides fee or commission based services through registered representatives. RJFS also includes the Investment Advisory Division (IAD), which is made up of independent offices that offer fee-only financial planning services. Currently there are 22 IAD offices with 77 Financial Advisors.

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Although RJFS agrees in principle with the NASD's goals as set forth in NtM 04-45, the current proposal may have adverse unintended consequences for the securities and insurance industries and for investors. As proposed, the new rules would require certain disclosures that may not always be true. For example, although variable annuities should generally be considered long-term investments, this may not always be the case. Further, the principal review and written supervisory procedures proposals require analysis of criteria that may not be relevant for a suitability review. For example, the requirement to review the "age and number of dependents" is not typically part of a suitability analysis and is not required under existing NASD rules. Additionally, RJFS has serious concerns about the proposal's provision requiring a separate disclosure document. Such disclosure, if required, should be created and provided by the insurance company issuing the variable annuity product.

As outlined in more detail below, RJFS agrees with and supports the NASD's investor protection goals but recommends modifications to the proposal that will accomplish the intended objectives without unduly burdening member firms and creating inflexible standards that may prove unworkable and not appropriate in all circumstances.

Specific Comments

Section (a). Appropriateness/Suitability

The NASD should strike the word "Appropriateness" from the header for Section (a) as the applicable legal standard is the "Suitability" of the product. The term "Appropriateness" is confusing, is inconsistent with current NASD terminology and has no basis in NASD rules.

Section (a)(1): General Suitability Review

Section (a)(1)(B) of the proposed rule states that a member shall not recommend the purchase, sale, or exchange of a deferred variable annuity unless the member believes that the customer has a long term investment objective. RJFS is confused by the use of the term "sale" in this context and believes that word should be stricken. If the NASD intends the term "sale" to mean "sale to the customer", this circumstance is covered by the term "purchase". If the NASD means "sale by the customer", a long-term investment horizon may not be a necessary component of the suitability analysis.

Section (a)(1)(B) of the proposed rule states that a deferred variable annuity is only suitable for a customer with a long-term investment objective. While in many cases this may be true, there are variable annuity products and certain circumstances under which a client with a shorter investment horizon may benefit from the purchase of a variable annuity. Certainly, variable annuities generally should be considered for longer-term investment objectives but occasionally may satisfy shorter-term investor needs. For example, occasionally fixed account interest rates available in no surrender charge variable annuities may be more attractive than interest rates

available through similarly liquid investment vehicles. Further, no guidance is provided as to the definition of the “long term”. This will result in both inconsistency and misinterpretation as to the term and its application. Rather than make a universal statement that may not be applicable to every situation, we recommend the NASD amend the proposed language to say, “the deferred variable annuity is suitable for the client’s investment time horizon”.

Section (a)(1)(C) of the proposed rule states the suitability determination should be “signed” by the associated person. It would be clearer to require that the determination be “evidenced” by the associated person to permit electronic review. The NASD staff has previously concluded that, with certain enumerated safeguards, a member may utilize electronic signatures for principal approval of new customer accounts and endorsement of transactions under NASD Rules 3110(c)(1)(C) and 3010(d)2.

Section (a)(2): Specific Customer Information

RJFS has serious concerns with proposed Section (a)(2). In general, member firms use standard new account documents to capture customer information in order to determine product suitability. Proposed Section (a)(2) adds several new items of information that are not currently required by member firms and would be unique to variable annuities. For example, the NASD proposes that member firms obtain information regarding the customer’s “financial situation and needs”. This implies a new standard that differs from the general “know your customer” standard. This language should be stricken. Additionally, the proposed requirement to obtain information regarding “liquidity needs” should instead read “time horizon” in order to harmonize with the method by which member firms currently capture such information.

The requirement to capture “liquid net worth” should be revised to read “investable net worth” to more accurately reflect the information sought. Further, information regarding the “number and age of dependents” is unnecessary to a suitability determination regarding variable annuity purchases and generally is not captured for brokerage customers. This information is normally obtained for estate planning purposes and is beyond the scope of services typically offered in a brokerage account. Further, this information is not currently required for other accounts where beneficiary information is required, such as an IRA or 401(k) plan.

The term “savings” may be redundant depending on whether a firm captures liquid or investable net worth. RJFS is confused by the NASD’s use of the term “tax status” in Section (a)(2). Is that the same as “tax bracket” which has been previously utilized by the NASD or does it reference non-qualified or qualified tax status of the investable assets considered for the variable annuity purchase?

² Interpretive Letter to Ms. Laurie Moret, American Express Financial Corporation (November 26, 1997).

Section (b)(1): Disclosure Documents

Section (b)(1) of the proposed rule states "Prior to effecting any purchase, sale or exchange of a deferred variable annuity, regardless of whether the transaction has been recommended,..." a member should provide a current prospectus and a separate disclosure statement. First, the requirement to provide a prospectus does not apply to a customer's sale of a variable annuity. As is currently required, prospectus delivery only applies to a customer purchase. Second, the NASD should consider replacing the word "effecting" with the term "completion of" which mirrors the requirements of Securities Exchange Act Rule 10b-10. In the alternative, the NASD should use the term "prior to execution" to be consistent with proposed Section (c)(1).

RJFS has a number of serious concerns regarding Section (b)(1)(B) of the NASD's proposal. First, it would be prohibitively time consuming and expensive for member firms that offer hundreds of different annuities to create, update and deliver product specific disclosure documents. This requirement should be placed upon the insurance company issuers with member firms being obligated to deliver them to the client prior to the completion of the transaction. Otherwise, this requirement would be to the detriment of the investing public as members will not offer as many products due to the burden of having to produce customized summaries. Further, having the insurance company issuers prepare the disclosures would alleviate the potentially confusing situation where customers of different member firms purchasing the same product likely would receive different disclosure documents.

In order to remedy these potential problems the appropriate entity to prepare these documents is the underwriting insurance company. The insurance company is in the best position to know what information to include and when and how to update the information. In addition, having the disclosures prepared by the insurance company issuing the particular deferred variable annuity will result in uniformity of the information provided to customers regarding a given contract.

Regardless whether the broker/dealer or the underwriting insurance company prepares the proposed risk disclosure document, RJFS recommends incorporating the risk disclosure document at the beginning of the prospectus rather than as a stand-alone document. Much of the specified disclosure items are already discussed in detail in the contract prospectus. It would be more helpful to customers to integrate the proposed risk disclosure document into the prospectus by including the information regarding the main features of the contract in the front of the prospectus, rather than provide customers with both a prospectus and a separate document. Combining the two into a single document would increase the likelihood that customers will read both of these disclosures.

There are certain problematic features of the content of the proposed risk disclosure document. First, a discussion of tax treatment on an individual transaction basis under Subsection (iv) would be unduly burdensome. As noted above, most member firms do not provide individualized tax advice to customers. The proposal does not indicate the specific tax features

that should be discussed, such as whether only the income tax treatment of variable annuities needs to be explained, or whether other areas such as estate taxes, gift taxes and generation skipping transfer taxes, or the degree of specificity that is required in the description of the tax treatment.

A general discussion of the federal tax treatment of annuities during the accumulation period, annuity payments, withdrawals and death benefits should be acceptable as a brief, easy-to-read disclosure that will help customers understand the principal tax issues involved with the purchase of a deferred variable annuity. State premium taxes vary from state to state, and most states do not levy a premium tax on annuities at all. Again, a general discussion about possible state premium taxes which can be part of a single, uniform disclosure document that can be used in all states should be sufficient.

The proposed rule requires that the risk disclosure document inform customers whether a "free look" period applies to the contract "during which the customer can terminate the contract without paying any surrender charges and receive a refund of his or her purchase payments." In fact, pursuant to the laws in a majority of states, many variable annuity contracts return the current contract value rather than the purchase payment (or the greater of the two) if a customer elects to terminate the contract during the free look period. We recommend that this provision in the proposed rule be modified to state that customers who terminate their contracts during the free look period will receive a refund of contract value or purchase payments, as specified by state insurance law.

The risk disclosure document, as proposed, also requires informing customers that all applications to purchase or exchange a deferred variable annuity are accepted subject to review and approval by a designated registered principal. This disclosure is not useful to a customer in determining whether the product is suitable for their needs nor would a typical customer understand the purpose of the principal review. This language might only serve to unnecessarily confuse investors about the effective date of their contract and should be stricken.

Section (b)(2): Exchange or Replacement Comparison

Section (b)(2) of the proposed rule would require providing additional information in the case of an exchange or replacement of a deferred variable annuity by the customer. This would include a comparison of all significant differences between the existing and proposed deferred variable annuity contract provisions, guarantees, death benefits, withdrawal provisions and/or tax treatment. The information would be required regardless of whether the transaction has been recommended. This comparison requirement will create practical problems when a member has not recommended the exchange or replacement of the contract. There will be many occasions when the member will not be able to obtain all of the specified information regarding the existing contract. For example, if the transaction is an external exchange or replacement, the member will not have a copy of the existing contract and will have to rely on the customer to provide the information.

Another area where the rule's requirement would not be practical would be variable annuity sales that are initiated by the customer directly with the insurance company. In this circumstance, the member will not have a copy of the existing contract to review nor opportunity to obtain the contract information from the customer.

We recommend that the proposed rule be modified so as not to require the comparison document in those instances where the customer initiates the exchange or replacement. To insure this is actually the case, the rule could simply mirror other instances where the NASD has required written confirmation from the customer that the transaction was initiated by them and not by the member.

Section (c): Principal Review

While review and endorsement by a registered principal, in writing, is already required for all securities transactions under NASD Rule 3010(d), the proposed rule would expand this requirement to require principal review not later than one business day following the date of execution of the deferred variable annuity application. In addition, where the transaction has been recommended, or involves an exchange or replacement, the registered principal must review, approve and "sign" the suitability determination document or the exchange or replacement analysis form, also within one business day of the execution of the application.

A one business day time period for principal review, approval and sign-off is not realistic and would dramatically impact how deferred variable annuities are processed by some members. In many instances, transactions and supporting documentation would have to be sent to a centralized location for the principal review which in itself could take more than one business day. Moreover, the type of thorough review contemplated by the proposal would likely include a review of the client file, review of appropriate corporate compliance reports, and in some instances, discussions with staff in order to answer questions and obtain additional information needed for approval of the transaction. This cannot be accomplished in one business day in all instances.

Additionally, one business day time requirement for deferred variable annuity transactions seems unnecessary since deferred variable annuities are the only investment products which, by state insurance law are required to provide a free look period during which the purchaser may change his or her mind regarding the investment decision and receive a refund. What is most important is the comprehensive principal review and approval prior to the expiration of the free look period, not that it must occur within one business day of completing an application.

Section (c)(1) sets forth specific criteria which the registered principal must consider in his or her suitability review. The proposed criteria should be set forth as guidelines for review. Not all firms use the same exception report criteria and the NASD should not take the unprecedented step of creating template exception report criteria. Each member firm should be responsible for determining how to analyze transaction information to determine suitability.

Barbara Z. Sweeney
NASD
August 9, 2004
Page 7

The word "sign" should be edited to read "evidenced" in Sections (c)(2) and (c)(3) for the same reasons noted previously.

Section (d): Supervisory Procedures

The numbered paragraphs in Section (d) are redundant since each of the items enumerated are already addressed in Section (c) of the proposed rule and required as part of the principal review. All that is required in this Section is the first paragraph.

RJFS sincerely appreciates the opportunity to provide comments on the proposed rule. While we appreciate the NASD's efforts to improve the quality and usefulness of disclosure and sales practices for variable annuity transactions, we would appreciate serious consideration of the recommendations included with this letter. Should you wish to discuss the comments with us, please feel free to contact me at your convenience.

Yours truly,

A handwritten signature in black ink that reads "Mark P. Barracca". The signature is written in a cursive, flowing style.

Mark P. Barracca
Vice President and
Associate Corporate Counsel

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