National Planning HOLDINGS, INC.℠

Michael A. Bell
Chief Legal Officer

Via Electronic Mail

August 9, 2004

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

Re: *Comment on Proposed Rule to Impose Specific Sales Practice Standards and Supervisory Requirements on Members for Deferred Variable Annuity Transactions*

Dear. Ms. Sweeney:

National Planning Holdings, Inc. appreciates the opportunity to comment on the NASD's proposed rulemaking in Notice to Members ("NTM") 04-45, June 9, 2004 (the "Proposed Rule") on behalf of each of its subsidiary broker-dealer firms, which include, National Planning Corporation; SII Investments, Inc.; Invest Financial Corporation and Investment Centers of America, Inc. We support regulatory reforms to address the issues identified in the Joint SEC/NASD Report on Examination Findings Regarding Broker-Dealer Sales of Variable Insurance Products, issued June 8, 2004 (the "Joint Report").

We support the NASD's effort to enhance investor education and protection. We support in principal, the concept of adapting the existing best practice guidelines into a rule that would uniformly apply across the industry. However, the Proposed Rule would go further by imposing significant new burdens on broker-dealer firms. We would respectfully urge the NASD and the SEC to consider our concerns before more costly and burdensome obligations are imposed on the industry. We strongly believe that the insurance industry must be a significant part of the rule-making process for the outcome to be truly meaningful to the investing public. Our specific concerns about the Proposed Rule are provided below.

I. Appropriateness and Suitability

General Suitability Provisions. Given that variable annuities contain characteristics of both securities and insurance products, equal weight should be given to both types of features. Consideration of subjective determinations, such as investor protection, should be integral in the suitability analysis. Unfortunately, the proposed list of determinations is superficial, and does not take into account many of the personal factors that motivate investors to purchase a variable annuity.

Consideration of an individual's need for security, estate planning, tax planning, and retirement planning is just as critical in determining the appropriateness of a variable insurance product as are age, net worth, and tax status when discussing these investments with a particular investor. Limiting the suitability determination to a one-dimensional list

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of factors in itself diminishes the very goal of rewriting these rules, which is to create a set of guidelines ensuring the highest level of suitability possible for the consumer.

Uniform Customer Information. Additionally, Section (a)(2) of the Proposed Rule requires that registered representatives obtain additional customer information, such as the investor's level of investment experience, for those investors purchasing a variable annuity contract. Creating a different standard of customer information for those individuals interested in variable insurance products creates an undue burden for registered representatives. Registered representatives will be required to recall more than one differing standard of information-gathering dependent upon the type of investment product the customer is considering. A set of uniform standards outlining the type of information to be maintained is less expensive, more accurate, and less confusing for registered representatives and consumers.

Variable Annuities within Tax Qualified Plans. We also take exception to the premise that variable annuities are unsuitable, per se, as a funding vehicle for all tax-qualified plans. Again, the suitability determination in this scenario is one-dimensional, limiting the analysis to potential tax advantages, with little regard for the investor's need to acquire investment products to implement their estate, tax, and retirement plans. Neither of the lists containing suitability determinations includes any factors which uncover the investor's behavioral reasons for investing in this type of product, increasing the potential for overlooking legitimate reasons the consumer may have for investing in a deferred variable annuity.

II. Disclosure and Prospectus Delivery.

Point-of-Sale Disclosure Concept. The interplay between state and federal regulations pertaining to point-of-sale disclosure documents, specifically the state-by-state requirements with regard to filing and review, must be examined to determine the feasibility (and jurisdiction) of implementing these requirements. The potential overlap in disclosure documents will result in additional consumer confusion compromising the suitability determination these rules are designed to support.

Short of uniform disclosure documents for all variable products, each broker-dealer or insurance company will be required to create and track disclosure documents for each product including state-specific variations of those disclosures. This could result in inconsistent information among insurance companies further confusing prospective investors. In addition, investors are likely to be confused and distracted from the prospectus when presented with multiple disclosure documents, calling the investor benefit in this scenario into question.

Furthermore, the point-of-sale disclosure concept is being currently reviewed by the SEC in an effort to determine the workability of proposed Rules 15c2-2 and Rule 15c2-3, which outline many of the same requirements set forth in the NASD proposal. The SEC is soliciting comments with regard to the cost of implementing these changes, and the NASD's final codification of these rules prior to the SEC's input would be premature.

Finally, implementing these rule changes without a uniform disclosure template will only add to the litigious environment surrounding the sale of variable insurance products that currently exists. If a uniform disclosure document is not used, the potential for errors and

omissions is high, and, as a result, plaintiff's attorneys could create an entire industry devoted to comparing disclosure documents, and then filing class action lawsuits based on any deficiencies found among the thousands of potential versions. This type of costly and inefficient litigation could be prevented with the release of a uniform disclosure document.

Comparison of Old and Replacement Contracts. Mandating a comparison of the old annuity's features and expenses with the replacement policy's features and expenses is not realistic. Often, the customer has not retained a copy of the original policy from which to do a comparison, and the original insurance company may no longer be in business or registered under the same name. The investor, at this point, pays the price; they are unable to exchange into a new contract offering the features and benefits most suitable to their needs.

As a result, a significant portion of the investing public will be "stuck" in old contracts, removing the incentive for insurance companies to remain competitive with new variable annuity products and features. Without the ability to exchange into an updated product, a portion of the investing public will remain invested in inferior and unsuitable contracts, compromising the progress made as a result of these new guidelines.

III. <u>Principal Review.</u>

Standards for Principal Review are Unclear. The proposed rule outlines several specific pieces of information that the principal will use when evaluating applications during the approval process. Among these required pieces of information are the customer's age; amount of investable assets; and the frequency of exchanged or replaced contracts for both the customer and the registered representative. Unfortunately, no parameters, or methods of evaluation, are outlined for this information, leaving the registered representative in the position of having to guess what the NASD *might* deem inappropriate. Requiring principals to comply with this rule, without the requisite tools to do so, again calls into question the premature nature of implementing these rules without valuable feedback from the industry.

One-day Business Turnaround. Under the new rule, the principal will be required to review, approve, and make a suitability determination within one business day of the customer signing the application. Given the increased disclosure documents that will be required, this turn-around time is impracticable and administratively unworkable. Many small firms do not have the resources to make a principal available on a 24-hour standby basis. In many situations, additional information may be needed from the customer; often, customers may not be able to produce this information within the time period necessary, preventing the principal from adhering to these guidelines.

Additionally, many principals for firms are located in a central home office where applications are processed, and registered representatives mail customer applications to this central office for processing. The Proposed Rule would require (i) a substantial investment in sales review personnel, and (ii) overnight or other electronic delivery services which would collectively add substantially to the cost of processing the transaction and place unwarranted time pressures on supervisors. Electronic mail is an option, however, given the nature and volume of proposed disclosure documents and the customer initials required, purely electronic applications are not feasible.

This short time frame provides no additional investor protection due to the current "free-look" period imposed by state insurance laws. During a "free look" period (which starts when an investor receives the policy), the investor can elect not to invest in the contract and can cancel the annuity contract without penalty or cost to the contract holder. An investor is adequately protected by the "free look" period that starts when he or she receives the policy. The one-day review requirement creates a substantial burden, the possibility of inadvertent errors, and no additional investor protection.

Multiple Required Sign-offs. Along with the multitude of proposed disclosure documents, the representative(s), as well as the principal, will be required to sign-off as part of the review and approval process. While this requirement in itself seems reasonable on its face, the one-day time frame to complete this task is again impractical when considering the cross-country locations of registered representatives and principals.

Furthermore, no discernable standards exist to determine what task a registered representative may perform that would require them to sign-off on the application. For example, one registered representative may host a seminar covering basic product information, a second registered representative may provide additional information, a third "associate person" may take information from the customer and submit the application for processing, a fourth person, the principal, reviews and approves the application, and so on. Each of these individuals may have separate supervisors, creating a confusing overlap of "sign-offs." This is a common scenario that is not addressed in the current rule proposal.

IV. Supervisory Procedures.

Without the benefit of knowing what the parameters are for assessing suitability and disclosure, as discussed above, it would be premature for us to outline appropriate supervisory procedures. Once feedback from the industry has been incorporated into the final version of these rules, the necessary system of checks and balances will become much more apparent given the guidelines that will be established.

V. Training.

Again, we are in support of creating a mandatory training program that would ensure all registered representatives and associated members are familiar with not only product-specific information, but also have a working knowledge of the suitability, disclosure, principal review, and supervisory requirements contained in the new rule. Details of this program, however, cannot be implemented until the substantive portion of the rule is finalized.

We agree that suitability and supervisory guidelines must be updated to prevent the abusive sales practices that the variable annuity industry is currently experiencing. Our concern, however, arises from the implementation of these guidelines without due consideration of input from industry participants. Enacting these rules prematurely will result in unworkable rules exacerbating consumer and registered representative confusion, without reaching the true goal of improving the assessment of investor suitability for these products. We urge the SEC and the NASD to examine the least restrictive means necessary to achieve these goals in order to prevent the institution of broad and overreaching rules.

VI. Recommendations.

We believe that meaningful steps can be taken to address concerns about sales practices for variable annuities, which would be far less burdensome and may be well more effective.

1. Develop Consensus Sale Practice Benchmarks. NTM 04-45 identifies several benchmarks that must be adopted by firms to properly sell and supervise the sale of deferred variable annuities. While flexibility is important, we would suggest that better-defined benchmarks could be more uniformly and consistently applied by the industry and regulators. We suggest a NASD/ industry task force be formed to establish more specific suitability and supervisory benchmarks and the situations when other facts and circumstances may justify exceeding those benchmarks. The benchmarks could be presented as a non-exclusive "safe harbor," thus preserving flexibility. The standards could be published by the NASD as "best practices" or as a rule. Input on these standards should be obtained from industry participants and experts, insurance companies and other financial services and professional associations.

2. SEC should review variable annuity prospectus disclosure requirements. Improving customers' understanding of variable annuity products is a critical part of addressing the concerns of the NASD and investors. The SEC, with NASD input, should review and revise the content and format of variable annuity prospectuses to make them more clear and user-friendly and to incorporate the NASD's proposed risk disclosure documents. This approach would best assure accuracy, completeness and uniformity of disclosures with the lowest overall cost of implementation – cost that will ultimately be borne by the customer.

3. Enhancement of Investor Education. The NASD should spearhead a joint NASD/SEC/insurance and securities industry task force to create an industry-wide educational brochure or disclosure document of general application, written in plain English, which could be delivered to all variable annuity customers prior to or concurrent with contract applications. The concept of a universal educational brochure has proven very effective in informing customers about options-related risks, for example. This educational material should cover commissions, costs, tax issues, risks associated with investing in sub-accounts, appropriate uses of variable annuities in an overall financial plan and the benefits and relative costs of added features such as dollar cost averaging, automatic rebalancing, stepped up death benefit and guaranteed income benefit. Customer acknowledgement of these disclosures could be built into application forms used by insurance companies, better assuring and confirming customers' basic understanding of the variable annuity products they are purchasing.

We support both reform and education of securities industry personnel to address the problems that have been identified by the SEC and the NASD in the Joint Report. The upward trend in customer complaints and enforcement proceedings involving variable annuities sales practices is a concern to our firm. We hope that the input provided above, is useful in assisting you in developing an efficient and workable approach to addressing these issues.

Thank you for the opportunity to comment on the Proposed Rule. Should you have any questions, please contact us at 720-489-6468.

Respectfully submitted,

/s/ Michael Bell

Michael Bell
Chief Legal Officer