MEMO# 20163

July 7, 2006

NASD Proposal Relating to Sales Practice Standards and Supervisory Requirements for Deferred Variable Annuities

 [20163] July 7, 2006 TO: SEC RULES COMMITTEE No. 31-06 VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 6-06 RE: NASD PROPOSAL RELATING TO SALES PRACTICE STANDARDS AND SUPERVISORY REQUIREMENTS FOR DEFERRED VARIABLE ANNUITIES The Securities and Exchange Commission has published for comment an amendment to a proposed rule change filed by the NASD relating to sales practice standards and supervisory requirements for transactions in deferred variable annuities.1 The most significant aspects of the amendment are summarized below. Comments on the amendment are due to the SEC no later than July 19. We will hold a conference call on July 12 at 2:00 pm Eastern to discuss the proposed rule change. The dial-in number for the call will be 888-323-2711 and the passcode will be 47369. If you, or someone else at your firm, plan to participate on the call, please contact Jennifer Odom by e-mail at jodom@ici.org or by phone at 202-326-5833. NASD proposed new Rule 2821 has four main provisions: (1) requirements governing recommendations, including a suitability obligation, specifically tailored to deferred variable annuity transactions; (2) principal review and approval obligations; (3) a specific requirement for NASD members to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the standards set forth in the proposed rule; and (4) a targeted training requirement for NASD members' associated persons.2 1 SEC Release No. 34-54023 (June 21, 2006), 71 FR 36840 (June 28, 2006) ("Release"). The Release can be found on the SEC's website at http://www.sec.gov/rules/sro/nasd/2006/34-54023.pdf. 2 The proposed rule would apply to the purchase or exchange of a deferred variable annuity and the initial subaccount allocations. The proposed rule would not apply to sales of deferred variable annuities to certain tax-qualified, employer- sponsored retirement or benefit plans. It would, however, apply if an NASD member makes recommendations to individual plan participants regarding a deferred variable annuity. 2 The proposed amendments are in response to comments filed on the original proposed rule change.3 The Release states that while some commenters expressed support for the proposed rule, most opposed it. In addition to general comments opposing the proposed rule, the Institute's comment letter on the original proposal focused on proposed recommendation requirements and principal review obligations.4 The NASD responded to these comments. Recommendation Requirements As

originally proposed, Rule 2821 would have required NASD members to have a reasonable belief that a customer had a need for the deferred variable annuity “as compared with other investment vehicles.” The Release notes that many commenters, including the ICI, criticized this provision. The Release states that NASD noted in its response to comments that it did not intend to require firms to perform a side-by-side comparison of a deferred variable annuity with other investment vehicles or require firms to prove that a customer needed the deferred variable annuity to the exclusion of all other investments. Instead, NASD intends to require firms to analyze whether a customer would benefit from the unique features of a deferred variable annuity. To clarify this, NASD eliminated references in the proposed rule to “need” and “as compared with other investment vehicles.” As revised, the proposed rule would require an NASD member or associated person to have a reasonable basis to believe that “the customer would benefit from the unique features of a deferred variable annuity (e.g., tax deferred growth, annuitization or a death benefit).” Principal Review Obligations The Release notes that some commenters, including the ICI, objected to requiring principal review of transactions that are not recommended. The Release states that NASD disagreed with these objections, noting that due to the complexity of the product, it is appropriate to require firms to review all deferred variable annuity transactions for problematic sales practices. NASD also stated that the proposed rule would create requirements to ensure that firms perform a consistent, baseline analysis of transactions, irrespective of whether the customer purchased the deferred variable annuity as a result of an associated person’s recommendation, thereby enhancing investor protection for all customers. Other Significant Changes The proposed rule would have required NASD members to have a reasonable basis to believe that a customer has been informed of the material features of a specific deferred variable annuity before recommending it. While noting in its response to comments that numerous commenters sought to eliminate this provision, NASD modified it to no longer require product-specific disclosure. As revised, 3 SEC Release No. 34-52046A (July 19, 2005), 70 FR 42126 (July 21, 2005). 4 Letter from Frances M. Stadler, Deputy Senior Counsel, Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated September 19, 2005. 3 the proposed rule would require a registered representative to have a reasonable belief that a customer has been informed of the material features of deferred variable annuities in general. The proposed rule also would have required principals to review and approve the purchase or exchange of a deferred variable annuity before the customer’s application was transmitted to the issuing insurance company for processing, regardless of whether the transaction was recommended. The Release states that NASD responded to commenters’ concerns by modifying the timeframe for principal review from “prior to transmitting a customer’s application for a deferred variable annuity to the issuing insurance company” to “no later than two business days following the date when a member or person associated with a member transmits a customer’s application for a deferred variable annuity to the issuing insurance company for processing.” Ari Burstein Associate Counsel