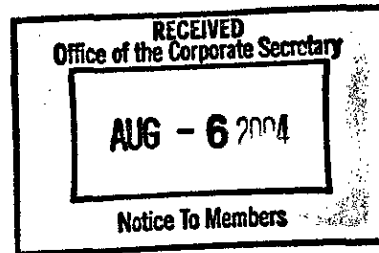




Dennis S. Kaminski
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August 3, 2004

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

Re: *Comments on Notice to Members 04-45 – Proposal Concerning Sales Practice Standards and Supervisory Requirements for Variable Annuity*

Dear Ms. Sweeney:

We are pleased to respond to the request for comments on the proposed rule changes outlined in Notice to Members 04-45 including codifying specific sales practice standards and creating special point of sale disclosure requirements and supervisory requirements for transactions in variable annuities (“The Proposal”).

Mutual Service Corporation (“MSC”), a broker-dealer member firm of the National Association of Securities Dealers, Inc (“NASD”), is licensed in fifty states and has over 965 branch offices and 1,775 producing representatives. MSC is also registered as an Investment Advisor with the Securities and Exchange Commission (“SEC”). The firm is licensed in all fifty states to sell life insurance and annuity products. MSC’s branch office managers and registered representatives are independent contractor business owners who provide financial and investment planning advice and securities transactions for their clients. MSC is an introducing broker-dealer and clears through Pershing, LLC, a subsidiary of the Bank of New York. MSC has dealer agreements with most significant variable annuity, mutual fund and variable life sponsors that make their products available for sale through a member firm or advisory firm. MSC also has agreements to introduce customers to a variety of third party money managers and specialized investment advisory services. MSC is a subsidiary of Pacific Life Insurance Company, which is a sponsor of variable life and annuity contracts and mutual funds. MSC does not provide for any differential compensation payouts on proprietary or any other products. Rather, MSC permits its representatives and their clients to access any available investment or advisory products on an equal basis, subject to MSC’s supervisory oversight and appropriate suitability considerations.

We have reviewed the “Joint Staff Report on Broker-Dealer Sales of Variable Insurance Products” issued by the SEC and NASD on June 8, 2004 (the “Report”) and other news releases and reports of enforcement actions concerning variable annuity business and we

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concur that a careful look at related sales practices and supervisory processes is appropriate. We also recognize that the SEC, NASD and other regulators have committed significant resources to regulation and enforcement with regard to variable annuity transactions. However, we are confident that existing rules and requirements, if consistently enforced, provide a sufficient framework for the regulation of variable annuity transactions. As detailed below, we believe that the Proposal is overreaching and, in some respects, would actually cause harm to the financial services industry and the public. We suggest that a further detailed guidance tool – perhaps an expanded and updated version of Notice to Members 99-35 would be timely and helpful. This would be particularly appropriate since so much time has passed since the NASD has crafted a comprehensive guidance tool for members involved in the sale of variable annuities.

Proposal Items We Support. As pointed out above, we are confident that existing rules combined with updated guidance from the NASD would provide an adequate framework for the regulation of variable annuity transactions. At the same time there are a number of items in the Proposal that we feel are reasonable and may be helpful if implemented.

- We would support codifying requirements that a current prospectus must be provided, that a representative must inform a client of the unique features of the variable annuity being presented, and that a representative must determine that the annuity as a whole and the sub-account(s) being recommended are suitable for the particular client.
- We suggest that a requirement that the client must have a long-term investment objective should not be codified. In most cases it would be an appropriate statement, but it begs the question of how long is long-term, and we do not think a definition of holding period is appropriate in the rules. Further, some annuities are designed for immediate withdrawals without tax or other penalties.
- We think presentation at the point-of-sale of a separate, plain language summary of the important characteristics of a variable annuity product would be helpful to a client. As pointed out below we feel strongly that such a summary, if required, should be created by the sponsor of the annuity and not by the selling broker-dealer member firm or its representatives.
- We agree that members that sell variable annuities should provide specific training concerning variable annuities for their principals who supervise such transactions and for their representatives who sell variable annuities. We think that current rules relating to Firm Element continuing education requirements provide adequate guidance on this; however, we would not be opposed to codifying specific training requirements by product lines.

- We agree that Variable Annuities may not always be an appropriate investment product in a Tax Qualified Plan, but may be suitable in certain circumstances. The Variable Annuity product may have certain features, advantages and benefits beyond the tax deferral features that may attract an investor. NAVA has published several articles on the application of Variable Annuity products within a Tax Qualified Plan. We strongly suggest the NASD acquaint themselves with these benefits and not presume that Variable Annuity products are unsuitable in a Qualified Plan solely for the reason of a tax deferred product in a tax deferred shell.

Proposal Items We Oppose. We believe the Proposal if implemented in its entirety would unfairly penalize firms that offer variable annuity products. The Proposal would be particularly onerous for firms like MSC that offer a broad line of variable annuity products and whose representatives are independent contractor business owners (“IC Firms”). A growing number of registered representatives – now probably over 200,000 – operate in the independent contractor environment. Many of these are financial planners and will only license with IC Firms that carry a very broad line of packaged products as well as providing access to the traditional securities markets. As pointed out below, it would be extremely difficult, if not impossible, for such firms to comply with certain provisions in the Proposal.

Following is a summary of our primary concerns about the Proposal:

- We believe that the customized disclosure and dramatically increased supervisory processes called for in the Proposal would create an unfair and undeserved competitive disadvantage for variable annuity products. We do not believe the increase in customer complaints or enforcement cited are a sufficient basis for concluding that variable annuities are a “bad” product or that their sale cannot be adequately supervised under existing systems. We acknowledge that there has been an increase in customer complaints, but these have not been isolated to variable annuity products. The Notice cites increased enforcement actions dealing with variable annuities; however it is our observation that enforcement actions have increased across all investment product lines. We also assume that the focus of regulators on variable contracts (e.g. variable sweep exams, etc.) automatically created an increase in variable annuity related enforcement actions.
- A member should be permitted to maintain one record of client suitability information accessible in conjunction with transactions in all product lines. We should not be required to maintain duplicative suitability documentation for variable annuity transactions.
- Any rule changes must take into consideration that after an initial purchase of a variable annuity, the client enters into a direct contract with the issuer and can unilaterally (e.g. without input or assistance from the selling broker-dealer or

representative) make additions to their investment, change sub-accounts or partially or fully liquidate their account. Thus, the NASD should determine if a member firm and representative have an obligation to monitor sub-account suitability post the initial investment date when the customer themselves effectuates exchanges between the sub-accounts.

- The requirement that variable annuity business be processed and supervised differently than any other product line would result in inefficiency and serious erosion of existing compliance and supervisory systems. It would require members to re-design systems, re-structure supervisory departments and add substantial numbers of supervisory personnel at a time when members are already struggling to implement a host of new rules and demands that have been promulgated by regulators over the past few years.
- The requirement that a supervising principal fully duplicate the selling representative's role in determining suitability with respect to every single variable annuity transaction is clearly overreaching. It assumes that no representative is capable of determining suitability for a variable annuity transaction. The result would be a substantial diversion of supervisory resources from other important duties and an unfair financial penalty on any firm that engages in variable annuity business. A firm that specializes in variable annuity business may have to double or treble its supervisory staff.
- The proposed requirement that every transaction involving an exchange or replacement be reviewed and approved by a supervising principal within 24 hours would be impossible for IC Firms, like MSC. Typically these firms have many small, remote offices without on-site supervisory staff. Their respective OSJ may be nearby or one hundred miles away. In addition, many of the field supervisors are also producers, necessitating supervisory oversight by home office based Principals. Variable annuity (and mutual fund) business in such firms is often done on an "application way" basis requiring transmittal of physical documents. The 24 hour turnaround time proposed would require use of overnight couriers thus, substantially increasing a member firm's costs and still may not allow enough time for proper supervisory review. Further, we believe if "buyer's remorse" or "high pressured sale tactics" are a concern, the investor remains protected by the "Free Look Period" which is mandated under most State insurance laws
- The requirement that a selling firm create a summary disclosure document to give clients every time a variable annuity is presented should be eliminated or substantially changed. Note the following:
 - The Proposal would require a new disclosure document custom to each variable annuity transaction and separate from the prospectus to be prepared by the selling member firm. The Proposal requires that the

document include liquidity issues, sales charges, fees of all types (including mortality and expense charges, administrative fees, charges for riders or special features and investment advisory fees), surrender charges, tax treatment considerations, and market risk. Covering these details would not result in a document that is brief or easy to read – the stated goal of the NASD.

- It is the variable annuity sponsors not selling firms that have the expertise, data, etc. needed to create and update disclosure documents.
- It is impossible for member firms that offer a wide variety of variable annuity products to create and maintain current, accurate disclosure documents for every potential transaction. A firm with a broad line of variable annuity products would be severely penalized. A firm with a proprietary or limited line or would be rewarded. A Variable Annuity product's internal expenses may change often and would require a constant updating of the written disclosure documents and the ability to detect each time an insurance carrier modifies their internal expenses.
- This requirement creates a regulatory quagmire and a huge civil liability trap for member firms that sell variable annuities. Each member firm would hire their own attorneys and a massive number of disparate documents would be created for each variable annuity product, resulting in wide discrepancies in disclosure to clients and massive duplication of effort. Unless the NASD provides a "safe harbor" by defining what has to be included and what can be excluded and what level of disclosure is adequate, then these disclosure statements will end up being a lot more like mini-prospectuses than summaries.
- The Proposal indicates a disclosure document so custom to the specific variable annuity transaction that it would require a different selling process than for any other financial instrument. Advance creation of a custom document is impossible if the client is permitted to make point of sale decisions as to choice of sub-account(s), optional riders, etc. It is hard to imagine how the document proposed could be handled in a typical telephone or single meeting sales environment.
- Sponsors would not be able to control the content and accuracy of these disclosure documents specifically describing the products they create and distribute, potentially adding to their regulatory and/or civil liability exposure.

We suggest that if the NASD believes that a summary disclosure and/or a plain language description of variable annuity contracts is really important, that one or more of the following alternatives be considered:

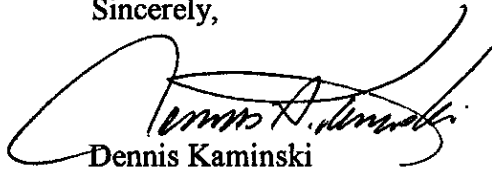
- That the NASD creates a generic plain language brochure describing variable annuities and requires that the broker-dealer deliver it to clients in connection with variable annuity transactions.
- That the SEC be petitioned to require variable annuity sponsors to provide a plain language summary as part of the prospectus or as a supplement to the prospectus.
- As referenced earlier, the Proposal taken in its entirety is unfairly burdensome for firms that carry a wide range of variable annuity products. MSC is a fairly good example of this. Most of our representatives are financial planning oriented and demand to be with a firm that provides a wide selection in every line of investment products. Therefore, we have selling agreements with dozens of quality sponsors and provide a selection of almost 400 distinct variable contracts. If the Proposal were implemented in its current form, MSC would have to commit the resources to be able to create a point of sale disclosure document on a moment's notice for any one of those products. Furthermore, MSC is not unique to this distinction and there are dozens of other fairly large independent contractor broker-dealer firms with a similar variable product universe.

Items for Consideration Similar to the creation of the NASD Mutual Fund Task Force established to explore industry Breakpoint problems, we suggest the NASD assemble a Variable Annuity Task Force Committee comprised of representatives from NASD staff, member firms, NAVA and Insurance carriers offering Variable Annuity Products. It is our belief this Task Force could provide tremendous support in achieving the NASD's goals yet, maintain the delicate balance of not promulgating regulations that are overly burdensome or impossible to enforce by member firms. It is our belief any changes as are currently reflected in 04-45 should be delayed until this Task Force could make its recommendations to the NASD.

We believe this Task Force could help clarify many issues including "Red Flag" standards as mentioned in the Proposal. For example, the Proposal discusses issues relating to investor age, absolute dollar amounts, and percentage of net worth or income as a potential "Red Flags" to which a member should be alerted. Actuarial studies conclude that people are living longer and life spans will most likely continue to increase. At what age does the NASD find a Variable Annuity recommendation troublesome, 60, 65, 70, 75? What is the percent of income or net worth that the NASD is uncomfortable with as a percentage? Without more specific information the suitability determination remains purely subjective and open to interpretation from member firm to member firm or NASD examiner to NASD examiner.

Thank you again for providing the opportunity for the industry to participate in the rule making process.

Sincerely,

A handwritten signature in black ink, appearing to read "Dennis Kaminski". The signature is fluid and cursive, with a large initial "D" and "K".

Dennis Kaminski
Executive Vice President