



ASSOCIATED SECURITIES CORP.

VIA ELECTRONIC MAIL ONLY

Rule-comments@sec.gov

September 19, 2005

Jonathan G. Katz, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: File Number SR-NASD-2004-183
NASD Proposal to adopt new Rule 2821

Dear Mr, Katz:

Associated Securities Corp. (hereafter "ASC")¹ appreciates this opportunity to comment on Amendment No. 1 to SR-NASD-2004-183 ("Proposed Rule") filed by the National Association of Securities Dealers, Inc. (NASD) on July 8, 2005. We also appreciate the additional extension of time the Commission afforded to the industry to comment on this important proposal.

As you are no doubt well aware, NASD is proposing to adopt a new rule, proposed Rule 2821, to create recommendation requirements (including a suitability obligation), principal review and approval requirements, and supervisory and training requirements tailored specifically to transactions in deferred variable annuities (hereafter "DVA"s).

While ASC is supportive of the NASD's efforts to enhance investor education and protection and is fully committed to the notion of improving and enhancing existing best practices guidelines in sales of DVAs, we are still of the opinion that the revised Proposed Rule is still problematic and in application would impose significant and costly new burdens on broker-dealers and create a variety of unintended consequences both for the investing public and the industry.

Therefore, respectfully, we recommend that the Commission decline to adopt the Proposed Rule 2821. We believe there are options that could more effectively address the perceived problems relating to the offer and sale of variable annuities in a more meaningful and cost-efficient manner than the Proposed Rule. Rather than implementing another regulation, we would respectfully urge the Commission to consider forming a joint industry (with representation from both the insurance and securities industry) and regulatory task force to address the regulatory issues relating to DVAs. This was done with great success in the

¹ ASC, an NASD member firm, is an independent contractor broker dealer servicing and supervising independent contractor registered representatives who provide financial planning and investment advisory services to their clients.

mutual fund industry, and we believe the implementation of a task force in the annuity arena would be a productive solution as well. Our specific concerns about the rule are noted below.

The Rule, if implemented in its current form, would create an unfair competitive environment for a product line that provides great value to the public. The NASD cites an increased volume of customer complaints as justification for this harsher treatment. We believe that any increase in customer complaints has affected all investment product lines, including mutual funds, and results primarily from market volatility, negative media coverage and increased promotion of litigation by plaintiff attorneys. The NASD also cites regulatory enforcement actions as a basis for imposing more restrictions on the sale of variable annuity contracts yet published information indicates that the volume of enforcement actions may be even higher with respect to other product lines such as mutual funds. It would appear that existing empirical, objective data does not support the need for the proposed rule.

Paragraph (b)(2) of the Proposed Rule provides that a member must make reasonable efforts to obtain certain product specific suitability information about the customer prior to recommending a DVA purchase or exchange. Although we support the NASD's listing of specific suitability criteria necessary to support a recommendation, we are concerned that certain product specific criteria listed by the NASD are either unclear or irrelevant to a suitability determination. For example, what constitutes a legitimate "intended use of the DVA"? Is either estate planning or tax deferral a legitimate "intended use" or would the NASD require a more detailed analysis? Similarly, to what extent does the NASD expect "existing investment and insurance holdings" to bear on the suitability determination? If the customer owns a life insurance policy, will the NASD determine that a DVA is unsuitable?

We are extremely concerned by the fact that the NASD believes it has to go far beyond the suitability criteria contained in its general suitability rule (Rule 2310) to establish a product specific suitability rule directed only at DVAs. The only other product specific suitability test imposed by the NASD outside Rule 2310 applies to options, currency warrants, index warrants and securities futures (see Rules 2860 and 2865). The suitability standards for securities futures described in Rule 2865 are not as onerous as those proposed by the NASD for DVAs. We believe the establishment of a new suitability rule for DVAs is unwarranted. If Rule 2310 provides satisfactory suitability standards for all other products except the volatile, high-risk products mentioned above, it should be appropriate for determining the suitability of DVAs. If the NASD believes that additional product-specific suitability criteria should be applied to DVAs, it should develop those criteria through discussions with manufacturers and distributors of these products. It should ensure that the criteria are clear and can be applied uniformly, and either add the product specific criteria by amending Rule 2310 or add the criteria by Interpretative Memoranda ("IMs").

Paragraphs (c) and (d) of the Proposed Rule require broker-dealers to establish certain specific suitability standards to be applied in connection with their supervisory review. For example, paragraph (c) provides that a principal shall consider, in their review of a specific transaction, the appropriateness of a sale: (1) to a customer over a certain age; and (2) where the amount being invested exceeds a stated percentage of the customer's net worth or is more than a stated dollar amount. In each case, the member must establish its standards for "certain age", "stated percentage" and the "stated dollar amount." We are very concerned that these standards are not defined or specified in the Proposed Rule and, therefore, our members will be second guessed when they attempt to do what they believe is reasonable in

light of their unique business model. Another unintended but inevitable consequence will be that different NASD districts will establish and impose their own standards, which will likely vary from district to district.

The Rule would not permit recommendation of an Annuity to a client unless that client has a "long-term investment objective" No clarity is provided as to what "long-term" means; so every firm has to determine the meaning and place themselves in jeopardy if the NASD disagrees. We are aware of no other situation where the NASD has taken a one-dimensional approach to suitability determination. Further, the Rule indicates that each firm is expected to set specific suitability standards such as prohibiting Annuity sales if a client is over a certain age, if the amount being invested exceeds a stated percentage of the customer's net worth or if the amount being invested is in excess of a stated dollar amount. Again, one must assume that the NASD has some age or amounts in their mind, yet they leave Firms to speculate as to what that criteria is. Frankly such measurements may be logical ways to establish screening methods to identify accounts that need a special review, but they do not constitute a practical approach to setting suitability standards. Two individuals with the same level of assets may be suitable for investing widely disparate amounts in Annuities depending on their cash flow, level of expenditures, risk tolerance, estate planning goals, etc.

The Rule requires that a supervising principal ("Supervisor") literally duplicate the Representative's role with respect to every single variable annuity transaction. The perception created by this Rule provision is that no Representative is capable of determining a client's suitability for any Annuity transaction. A duplication of the Representative's role would require that a Supervisor have detailed personal knowledge of the customer and sign off on a detailed suitability summary. In the case of an Annuity transaction involving a 1035 exchange, the supervisor would be required to personally review a detailed comparison of old and new contract. A Firm providing access to a large number of variable contracts would be forced to allocate two to three times the supervisory staff for Annuity transactions than for any other product line. Such requirements would result in a substantial diversion of supervisory resources from other important duties and create an unfair financial penalty on any firm that engages in Annuity business.

Meeting the Rule requirement that Annuity applications be held by the firm until a Supervisor reviews and approves each transaction would be unfair to Annuity investors, who have as much right as anyone else to timely execution. Substantial liability may inure to Representatives, Supervisors and Firms due to market value changes during such delays in submitting applications. In the context of most investment accounts holding back customer funds would subject a Firm and/or a Representative to severe penalties.

ASC and most member firms have spent considerable resources improving systems for documenting and maintaining suitability information in order to comply with recently enacted regulations (the amendments to the SEC Books and Records for example). Suitability is an important part of any investment account and it is not practical to maintain separate, duplicate information for specific Annuity transactions. Modern systems for documenting suitability are tied to the process of opening and maintaining a securities account rather than being tied to specific product lines and/or transactions. Most Representatives work with their clients to build diversified investment portfolios crossing over multiple product lines. It would be an enormous waste of resources and very frustrating for their clients if those Representatives were required to create separate suitability documentation for each type of product included in those portfolios.

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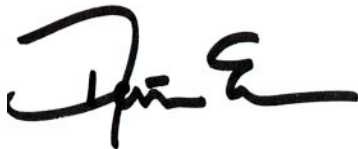
We do believe as the NASD indicates, that member firms should provide specialized training for those Representatives involved in the sale of Annuities. It seems to us that this is already required under the Firm Element of the NASD Continuing Education rules, and is something that ASC added as an additional core subject to our continuing education firm element program in 2003. However, we further support the NASD reminding firms of this need and also recommend that the NASD work with industry members to create additional and appropriate training tools and programs.

We also believe that any sales practice, suitability and supervisory issues relating to Annuities can be addressed by enforcing existing rules. We do not believe that sales abuses have occurred because the NASD's rules and enforcement mechanisms were not strong enough to prevent them. We strongly suggest that an Annuity Task Force be established with full participation by both industry and regulators to fully explore sales practice, pricing, suitability, supervision and other regulatory concerns relating to Annuities. As the NASD points out, modern Annuities are complex, hybrid products that combine both investment and insurance attributes. Further, issues relating to Annuities are complicated by a unique blending of state and federal regulatory responsibility and the direct competition between registered and non-registered annuity products. We believe an Annuity Task Force could greatly assist regulators in finding practical solutions to any outstanding regulatory issues related to the distribution and sale of Annuities.

In conclusion, we believe the SEC should reject Rule 2821 as presented. Rather, we believe that the NASD should be asked to provide to its members an updated sales practice advisory regarding Annuities transactions. Further, we believe that the NASD should continue to aggressively enforce existing NASD Rules on suitability and supervision as they relate to all investment transactions including Annuities. Finally, we strongly suggest that an industry/regulatory task force be formed to address any outstanding regulatory issues relating to Annuities.

Again, we appreciate the opportunity to comment on this proposed regulation.

Very truly yours,



Denise M. Evans, Esq.
Sr. Vice President, General Counsel

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