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VIA ELECTRONIC MAIL TO
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September 19, 2005

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. SR-NASD-2004-183 (Self-Regulatory Organizations; National Association of Securities Dealers; Notice of Filing of Proposed Rule and Amendment No. 1 Thereto Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities; Corrected)

Dear Mr. Katz:

Wachovia Securities, LLC ("Wachovia") appreciates this opportunity to provide further comment upon the above-referenced file in which NASD has proposed new Conduct Rule 2821 relating to the sale and supervision of deferred variable annuities (the "Proposed Rule").¹

Wachovia services approximately 5.7 million active retail accounts in 49 states with a wide array of financial products and services, including variable annuities. As such, Wachovia has already invested significant resources in furtherance of the goals that NASD offered in support of the Proposed Rule. Thus, although Wachovia generally supports the U.S. Securities and Exchange Commission's (the "Commission") efforts to further educate the investing public and enhance investor protection, we have reservations about the Proposed Rule. Wachovia believes that: 1) requiring a member firm to pre-review of all variable annuity purchases, regardless of its underlying facts and circumstances, presents a substantial and unnecessary burden on a firm's supervisory resources; 2) certain components of the Proposed Rule are vague and impracticable; and 3) the disclosures that NASD suggests would be necessary to comply with the Proposed Rule impose a *de facto* disclosure regime, which is at odds with the Commission's current initiative regarding point of sale disclosures. In addition, Wachovia also believes that NASD should expressly permit a member firm to discharge its training requirements within its existing Firm Element program. We address each of these concerns in turn below.

¹ See SEC Rel. No. 34-52046A (July 19, 2005).

I. The Proposed Rule's Mandatory Pre-Approval Requirement Will Present a Substantial and Unnecessary Burden on a Member Firm's Supervisory Resources.

Under Proposed Rule 2821(c)(1), a member firm's registered principal² must review and approve a purchase or exchange of a variable annuity "prior to transmitting a customer's application . . . regardless of whether the transaction has been recommended." As a part of this review, the registered principal must consider a number of factors, including whether the customer has a "need" for the annuity's features or the customer's age or liquidity requirements make such an investment inappropriate. Setting aside for the moment the discussion on whether a registered principal can reasonably address these factors, Wachovia submits that such a requirement places a tremendous and costly burden on the principal and the entire transaction process as a whole. NASD has acknowledged through various investor and industry publications, and even in this present proposal, that a variable annuity is a complex, multifaceted product.³ Among the features a variable annuity typically offers are a range of different investment subaccounts, one or many death benefits, certain guarantees upon annuitizing or withdrawing assets from the contract (otherwise known as "living benefits" and "withdrawal benefits"), dollar cost averaging programs and portfolio rebalancing features. Analyzing these features using the Proposed Rule's mandatory factors would not be a simple task. Rather, it would amount to an intricate, multidimensional review that is loaded with the potential to overwhelm a principal. It is conceivable that each transaction would require the principal to conduct a review of the transaction with the registered representative, perform another review with the client, and finally, research the variable annuity under discussion. This is compounded if a firm offers a number of annuities to its clients. We believe that this would pose a tremendous obstacle to a registered principal discharging his or her duties. Alternatively, we believe that if the Proposed Rule is adopted as presented, then it would undoubtedly force a firm to reduce its product offerings – and, as a result, limit investor choice – to meet its burden.

Wachovia respectfully suggests a more measured approach. Instead of requiring a registered principal to pre-review all variable annuity purchases, regardless of the underlying facts and circumstances, NASD should permit a member firm to implement a needs-based pre-review process. Under such a process, a member firm

² Wachovia notes that under Proposed Rule 2821(a)(4) a "registered principal" includes an associate registered as a General Securities Sales Supervisor (Series 9/10), a General Securities Principal (Series 24), or an Investment Company Products/Variable Contracts Principal (Series 26). Our comments use the terms "registered principal" and "principal" interchangeably to refer to an appropriately registered associate.

³ See, e.g., "Variable Annuities: Beyond the Hard Sell," available on Sept. 13, 2005 at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_005976 (May 27, 2003) and "Should You Exchange Your Variable Annuity?," available on Sept. 13, 2005 at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_006045&ssSourceNodeId=1232 (Feb. 15, 2001).

would establish certain criteria that, if met, would then subject the transaction to a comprehensive review by the registered principal before the application is processed. The criteria could include the client's age, the percentage of the client's assets to be invested in the annuity, and/or whether the purchase is an exchange or with new money. These criteria could also be expanded as a member firm sees fit to meet its objectives. As noted in our earlier comments on this subject,⁴ the selective review of trades by a principal will help a firm arrive at consistent suitability determinations while simultaneously allowing it to use technology to uncover practices that may require more attention. In other words, such an approach would shine the supervisory spotlight on the appropriate transactions and preserve precious resources to meet the changing regulatory landscape. Furthermore, such an approach would help minimize the conflicts NASD acknowledges may arise between the Proposed Rule and other applicable standards.

II. Certain Components Of The Proposed Rule Are Vague And Impracticable.

Hand in hand with Wachovia's comments about the burden that the Proposed Rule would place on a member firm's supervisory resources are our concerns about what the Proposed Rule would require of a member firm to discharge its duties. Our concerns follow:

- a. *The "needs" analysis set forth in Proposed Rule 2821(c)(1)(A) is unworkable and should be removed.*

In the Proposed Rule 2821(c)(1)(A), a registered principal must consider whether "the customer *appears to have a need* for the features of a deferred variable annuity as compared with other investment vehicles" (emphasis added). We respectfully submit that such a standard is unworkable. First, executing this analysis would be cumbersome at best. As explained above, it is very conceivable that, to fully gauge the "need" for the product, a registered principal would not only have to review the proposed annuity's benefits and features, but also all of the benefits and features associated with the other variable annuities available to the registered representative. In addition, it almost certainly follows that such an analysis would require the registered principal to re-review the transaction with the client in person or via the telephone. Contacting the client and finding a mutually agreeable time at which to discuss the transaction would undoubtedly add considerable time to the process. This assumes, of course, that the client would be amenable to what amounts to a second presentation concerning the investment.

Second, and equally as important, it is unclear how exactly one could "consider" whether a client "appeared to have a need" for a particular variable annuity or the features within the variable annuity. It is reasonable to foresee disagreement on this

⁴ See the letter from Ronald C. Long, Regulatory Counsel, to Barbara Sweeney, NASD Office of the Corporate Secretary (August 10, 2004) (available at http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_010245.pdf).

amorphous and subjective standard. For example, an annuity's death benefit pays a benefit to the prospective owner's beneficiaries, not the owner herself. A registered principal's view of whether insurance is a "need" will undoubtedly color her judgment. Her perspective on whether the investor "appeared" – however, that is defined – to need it will also play a large role. It does not take a leap of faith to anticipate similar disagreements over other annuities and their various features.

Therefore, we ask that the Commission remove this requirement from the Proposed Rule.

- b. It is unclear what a "particularly high rate" of exchanging variable annuity contracts means.*

Wachovia notes that under Proposed Rule 2821(d)(5) a firm is required to design supervisory procedures to ensure that a registered principal review a transaction that involves a registered representative that has a "particularly high rate of effecting deferred variable annuity exchanges." We believe that this standard begs, but does not resolve, a number of serious questions. What is a "particularly high" rate? Should the member firm look at the representative's variable annuity exchanges vis-à-vis his variable annuity clients or all of his clients as a whole? Should the firm confine its analysis to a certain period? May a firm consider other factors, such as changes within the variable annuity market generally or a certain issuer's rating in particular, to determine if the representative's exchange rate is "particularly high"? All of these questions are critical to the analysis and all of these are unanswered. Therefore, we respectfully request that the Commission ask NASD to provide further guidance on this point.

- c. Similarly, NASD should also provide guidance on appropriate age and net worth factors for determining whether the variable annuity transaction was suitable.*

The Proposed Rule also mandates that the firm establish age and net worth factors that a registered representative and a registered principal must consider before recommending and approving a variable annuity purchase. Conspicuously absent, however, is any guidance as to what these factors should be. Wachovia respectfully requests that the Commission request NASD to amend the Proposed Rule to provide such guidance to help member firms discharge their supervisory duties. Absent this information, a firm faces potentially arbitrary and conflicting *ex post* determinations by regulators as to what the appropriate limits should have been. We note that NASD provided the membership with exactly this guidance in another part of the Proposed Rule with respect to the frequency with which an investor proposes to exchange a variable annuity contract.⁵ In addition, in the spirit of providing greater clarity for the

⁵ See Proposed Rule 2821(c)(1)(D) and 2821(d)(4), both of which encourage a member firm to consider whether the client is proposing to exchange his or her contract within 3 years of its initial purchase.

Proposed Rule, we ask that the Commission modify any reference to a customer's "net worth" to read a customer's "*stated* net worth"

III. The Disclosures That NASD Suggests Are Necessary To Comply With The Proposed Rule Impose A *De Facto* Disclosure Regime, Which Is At Odds With The Current SEC Initiative Regarding Point Of Sale Disclosures.

At Footnote 15, the Release states:

Pursuant to this requirement, the associated person *should, at a minimum, highlight* for the customer the following material features of the deferred variable annuity: (1) The surrender period; (2) potential surrender charge; (3) potential tax penalty if the customer sells or redeems the deferred variable annuity before he or she reaches the age of 59½; (4) mortality and expense fees; (5) investment advisory fees; (6) charges for and features of enhanced riders, if any; (7) the insurance and investment components of the deferred variable annuity; and (8) market risk (emphasis added).⁶

Wachovia is concerned that, although NASD removed the written disclosure requirement from the Proposed Rule in deference to the Commission's current initiative regarding oral and written point of sale disclosures,⁷ its expectation manifested in Footnote 15 in fact imposes a mandatory disclosure regime upon the membership. This is ripe with the potential for conflict with any subsequent point of sale standards. While we recognize that this guidance is similar to that NASD provided in Notice to Members 99-35,⁸ in view of the Commission's present review of point of sale disclosures, Wachovia asks that NASD remove any such expectations or guidance until such time as the Commission has provided the membership with its determination on point of sale disclosures.

IV. A Member Firm Should Be Permitted to Meet Its Training Requirement Through Its Existing Firm Element Programs.

Proposed Rule 2821(e) requires members to develop and document specific training policies or programs to ensure compliance with the Proposed Rule. Wachovia supports this effort and asks that NASD permit the membership to discharge this duty through its existing Firm Element programs as opposed to mandating the creation and implementation of separate training for variable annuities. We feel that this would be consistent with NASD's goal to provide more comprehensive training for associates regarding this product.

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⁶ 70 FR 42126, 42128 (July 21, 2005).

⁷ See SEC Rel. Nos. 33-8544; 34-51274; IC-26778 (Feb. 28, 2005).

⁸ See the "Customer Information" section under Notice to Members 99-35 (May 1999).

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In summary, Wachovia commends NASD for its thoughtful revisions to the Proposed Rule. However, we believe that the Commission must address significant issues before the Proposed Rule can provide any meaningful and effective oversight. Further, given the scope of the Proposed Rule, Wachovia respectfully requests that the Commission provide for transition period of at least one year so that we may be able to implement the necessary operational and training systems.

Wachovia trusts that the above is responsive to the Commission's request for information and would be pleased to meet with the Commission or its Staff to answer any questions regarding this matter.

Respectfully,

/s/ Ronald C. Long

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/s/ Ryan P. Smith

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