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Wachovia Securities, LLC

August 22, 2004

Ms. Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street N.W.
Washington, D.C. 2006-1500

Re: NASD Notice to Members 04-45, Proposed Rule Governing the Purchase, Sale, or Exchange of Deferred Variable Annuities

Dear Ms. Sweeney:

Wachovia Securities, LLC ("Wachovia Securities") appreciates the opportunity to comment on the above-referenced Proposed Rule. We are fully supportive of the general concept that members offer deferred variable annuities to investors in a manner consistent with both the letter and the spirit of all applicable existing rules. We write this comment letter to express our view that any changes to the current underlying rules governing these sales not so burden the process and blur lines of responsibilities such that investors for whom the deferred variable annuity product is proper lose the opportunity to have the product as a part of their overall investment portfolio.

I. Introduction and Overview

Wachovia Securities is a full service brokerage firm serving clients in 50 states. It assists retail clients in purchasing a wide array of investment products, including deferred variable annuities. As such, the firm fully supports the concept of having informed investors make appropriate decisions to include, where suitable, annuity products as a part of their overall investment portfolio. We comment briefly on the Proposed Rule to highlight concerns that, in some respects, the rule would not accomplish the goal of informing investors, and in fact, may make it more difficult for individuals to make decisions concerning the deferred variable annuity product.

II. The Proposed Rule Should Be Deferred

Even before one looks at the Proposed Rule in detail, the overwhelming conclusion is that this rule should be tabled pending a top-to-bottom review of the overall system for the distribution and sale of mutual fund and annuity products. As NASD recognized, the SEC is currently reviewing comments related to a rule proposal concerning point of sale disclosure of fees and other costs for several products including variable annuities.[1] If enacted as proposed, at point of sale and as a part of the confirmation process, investors would receive information that would virtually insure that all information sought in the Proposed Rule is featured in point of sale material as well as the confirmation. More importantly, where the Proposed Rule may cover areas not covered in the SEC rule, the tremendous cost of going forward with two separate disclosure regimens seems to beg that the two regulatory agencies, and other significant participants in the investment industry[2], coordinate and cooperate to find common ground such that investors could receive the relevant information in a digestible form that does not impose excessive costs on the system that eventually will be borne by the individual investor.

III. Suitability

In turning to the actual provisions of the Proposed Rule, Wachovia Securities supports the "Appropriateness/Suitability" and "Supervisory Procedures" features of NASD's suggested approach. Each of these provisions is emblematic of best practices firms should follow, and Wachovia Securities daily works towards that ideal. The one

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[1] *See* SEC Proposed Rule Regarding Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, Rel. Nos. 33-8358, 34-49148, IC-26341 (Jan. 29, 2004), 69 Fed. Reg. 6438 (Feb 10, 2004).

[2] The Investment Company Institute, the Securities Industry Association, the North America Securities Administrators Association and the American Council of Life Insurers are just some constituents who could convene a summit designed to tackle the important issues related to the entire packaged securities products distribution system. A piece meal reform process has the likelihood of devolving into a system of rulemaking "whack-a-mole" that ultimately fails investors.

caveat is that there should be considerable flexibility into how such suitability determinations are documented and "signed". Many firms may use electronic methods of documenting suitability determinations. Such electronic systems should be encouraged as they aid the overall supervision of a broker's activity. An electronic "signature" should satisfy the Proposed Rule's concerns, and the language of the rule should be changed to permit that flexibility.

One area that may need addressing is subsequent changes to the variable annuity sub-accounts by the investor without broker input. The nature of many deferred products permits the investor, after purchase, to make switches between sub-accounts directly with the insurer. It is unclear from the rule proposal whether such independent action by an investor exposes a broker to claims that the sub-accounts into which an investor exchanged were, or later became, unsuitable.

IV. The Risk Disclosure Document

The "Disclosure and Prospectus Delivery" provision raises some strong concerns for Wachovia Securities. While apparently an effort to give information to investors, the Proposed Rule seems to take the broker dealer out of its traditional role and attempts to make it the issuer and underwriter of deferred variable annuity products. In addition to providing investors the prospectus, NASD would impose upon the broker dealer a requirement that it also supply a separate risk disclosure document. At the outset, this disclosure information should already be fully contained in the prospectus. Having this same information presented to customers in the prospectus and then again in the risk document begins to become unnecessarily repetitive to the average investor. This layering has the potential to turn the investment process into one that appears as convoluted as it is confusing, with the risk that investors for whom a deferred variable annuity product would be appropriate simply decline to buy the product out of frustration.

In addition, NASD's decision to put risk disclosure obligations, a traditional duty of the issuing insurance company, on the brokerage firm seems to create a new opportunity for litigation against brokerage firms by those who do not like the disclosure document. Full service brokers will find the rule as drafted unduly burdensome as the firms create a vast number of separate risk disclosure documents for all of the different products. For example, the Proposed Rule requires that a firm track the tax treatment and other fees for each of its annuity products offered. The Proposed Rule therefore becomes extremely costly and burdensome for broker dealers who distribute a wide offering of variable annuities.

Equally of concern, some of the information required in the risk disclosure document seems redundant or unnecessary. The Proposed Rule demands a statement that

the application is subject to review and approval by a registered principal.[3] Such a statement is of questionable benefit to the investor. More importantly, it is a statement that can be injurious to the development of the proper relationship between the registered representative and the customer. After doing an overview of a client's financial information and making a recommendation, it can be off-putting to learn that the broker's judgment is not trusted. There is properly in place a review mechanism for unsuitable trades, and to disclose that there will be a review for unsuitable trades in no way enhances investor education or product information. The only purpose, some might say, is to place brokers under the light of suspicion. Receipt of a risk disclosure document has no impact upon a suitability determination, and suitability determinations properly include an explanation of all the risks. It is important that the investment selection process is not so overloaded with repeated and excessive information such that planning an investment portfolio becomes a tortuous experience and one that does harm to the development of the broker-client relationship.

Where NASD insists on a risk disclosure document, it seems preferable that the document come in the form of an education piece that provides an investor with information on the various types of fees and charges applicable to all deferred variable annuity products. This educational material will both inform the investor, and unlike a compendium of disclosures on one investment, it allows an investor to understand the full range of products so that she could place the investment in context with the wide range of fees, charges and risks involved in the deferred variable annuity arena.

V. Principal Review

Appropriate review and supervision is a key component of any effective brokerage program, and Wachovia Securities strongly supports that concept. Nonetheless, the principal review provisions of the Proposed Rule presents many issues that should be resolved prior to any passage of the rule. The Proposed Rule requires that a principal review and approve *each* deferred variable annuity application. NASD would insist that this review take place no less than one business day following the date of execution of the application, and the review must take place regardless of whether the client selected the product without the broker's input. Such a transaction review requirement for a principal places an enormous operational burden on principals and the brokerage process itself. More importantly, the six different factors on which the principal must review every deferred variable annuity purchase amount to a multilevel review that would quickly overwhelm a principal. There would be a multiplicity of permutations among these six factors, and a principal would face going through several

[3] "In addition, the risk disclosure document must inform the customer that all applications to purchase or exchange a deferred variable annuity are accepted subject to review and approval by a designated registered principal." NASD NTM 04-45 at A2.

matrices as she makes a judgment on each transaction. Principals should not be burdened in this fashion.

If NASD moves forward with this concept of a principal review, then it needs to consider a variant on its suggestion in the NTM of a "bright line,"[4] and establish investor eligibility categories. Under this process, NASD would establish categories of investors who, because of their combination of factors, are limited as to which deferred variable annuity products they could purchase. With such categories, a principal's review would consist of insuring that any deferred annuity investor fit into NASD's predetermined box. While such a system would do considerable violence to the strongly-held notion of investor choice, it would be preferable to a process that, as now proposed, would constantly subject principals to ad-hoc, after the fact second-guessing of the principal's review of transactions and application of the six factors. Moreover, this sort of "check the box" review will probably make it more likely that principal reviews take place within the extremely tight time period presently in the Proposed Rule.

NASD probably needs to eliminate the principal review provisions. Viewed dispassionately, the goal that NASD wishes to achieve can be reached in a less costly, less burdensome manner by having a firm incorporate in its supervisory and surveillance procedures a system that helps monitor trades, isolates those of concern and singles them out for closer review. The selective review of trades by a principal will help the firm insure that the overall suitability determinations are consistent across the firm while at the same time allowing the firm to use technology to uncover offices and broker patterns where more attention may be required. Such a system could be a part of the supervisory procedures proposed in the rule, and it will make both the individual brokerage firm and the industry overall more consistent in the handling of deferred variable annuity sales. It is also worth noting that NASD Rule 3010 requires that firms establish procedures reasonably designed to achieve compliance with rules. By requiring a review of all transactions, the Proposed Rule eliminates this latitude and prevents firms from fashioning appropriated compliance schemes. Moreover, the principal review of all annuity purchases within one day undermines NTM 99-35, which itself recognized that certain sales (e.g., replacements or those to persons of a certain age) required a level of managerial attention that other transactions did not.

Finally, should the rule insist on a principal review, that review should be permitted to occur in a 72-hour period as opposed to a one-day period. One day simply is unrealistic, and where many products permit an investor to have a free look period, firms can work at a pace that will allow them to decide to review the transaction earlier or later within the 72-hour cycle. Extending the review period extends the length of the free-look period.

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[4] NASD NTM 04-45 at p. 7.

VI. Conclusion

Wachovia Securities repeats its view that having an effective system for the distribution of deferred variable annuity products is in the best interest of the firm, its financial advisors and investors. Our comments on the Proposed Rule are designed to help achieve that goal. We again appreciate the opportunity to provide these comments, and we would be pleased to answer any questions or provide more information to NASD or its staff as they work through these important issues.

Very truly yours,

Ronald C. Long

Ronald C. Long,
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Wachovia Securities, LLC