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September 19, 2005

Mr. Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-9303

Re: File Number SR-NASD-2004-183

Dear Mr. Katz:

On behalf of H.D. Vest Investment Services ("H.D. Vest"), I would like to thank the U.S. Securities and Exchange Commission (the "Commission") for the opportunity to comment on SR-NASD-2004-183, the NASD's proposed rule relating to sales practice standards and supervisory requirements for transactions in deferred variable annuities (the "Proposal" or "Proposed Rule"). H.D. Vest is a registered broker-dealer with over 5,000 registered representatives. H.D. Vest endeavors to meet clients' needs by making a broad range of investment solutions – including deferred variable annuities – available for our registered representatives to offer to their clients. We currently have selling agreements with over forty variable annuity product sponsors.

Although the Proposal is duplicative in many respects of existing guidance, as a general proposition we do not oppose the adoption of reasonable standards governing the sale and supervision of variable annuities. Our support for the rulemaking process is based on the belief that it is much more efficient and fair to adopt rules, with the benefit of notice and comment, than to attempt to set standards through enforcement proceedings. The rulemaking process produces healthy debate concerning proposed regulatory initiatives, which is good for regulators, the securities industry, and investors. The debate surrounding this Proposal is a good example of that. The notice and comment process allows rulemaking bodies to consider a broad range of policy implications that might not receive a full hearing in the enforcement context. In this regard, we concur wholeheartedly with NASD Chairman and CEO Robert Glauber, who has stated that the NASD's mission is to "set clear and appropriate rules and enforce them rigorously and consistently."[1]

In several respects, however, the Proposed Rule falls short of this ideal. In particular, this letter will address the requirements that a representative reasonably believe that an investor: (1) has a long-term investment objective; and (2) has been fully informed about the material features of an annuity. We believe that implementation of these requirements will raise significant issues. Our specific comments on the Proposed Rule are set forth below.

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[1] Quoted on the NASD's Internet homepage, www.nasd.com.

I. Variable Annuities Do Not Lend Themselves to Product-Specific Suitability Rules

There is no doubt that variable annuities are complex products. In recent years, product sponsors have added many new features to their products. These product innovations are a good example of the free market at work, and they benefit investors by meeting a broad spectrum of needs. But they also make the products even more complicated.

We support the goal of ensuring that investors receive adequate disclosure about the features of a variable annuity. Regardless of the product involved, investors are entitled to receive any and all information they need or want to make an informed investment decision. We also support the goal of ensuring that brokers who sell variable annuities have a reasonable basis for the recommendation, and that broker-dealers adequately supervise annuity sales.

However, the Proposed Rule fails to give adequate guidance as to how to achieve these worthwhile goals. The very complexities that are the catalyst for the Proposal also make it difficult to come up with a rule of general application to govern whether a product is suitable for a customer in connection with a particular transaction. The general suitability standards have long recognized that suitability is a fact-specific inquiry that does not lend itself easily to micromanagement through specific rules. Ambiguities in the Proposal will result in it not accomplishing the desired goals, while at the same time imposing significant costs on firms that sell deferred variable annuities. Ultimately, the Proposal will increase the cost of purchasing these products and reduce consumer choice.

II. Time Horizon Should be Only One Factor in Determining Suitability

The Proposed Rule would require that, before recommending a variable annuity, a registered representative have a reasonable belief that "the customer has a long-term investment objective."[2] The "long-term investment objective" is listed as a requirement separate and apart from the general requirement that "the deferred variable annuity as a whole" be suitable. There are several problems with this aspect of the Proposal.

By elevating a "long-term investment objective" over other suitability criteria, the Proposed Rule effectively creates a "veto" based solely on the investor's time horizon. Although variable annuities generally should be considered long-term investments, that might not be the case in all instances. The Proposed Rule should be flexible enough take into account the individual characteristics of (a) the investor, and (b) the product.

For example, an investor with a shorter investment time horizon might knowingly decide to purchase an annuity and incur certain surrender charges in exchange for other benefits the annuity could provide. Other investors might have a shorter investment time horizon due to health issues, but the features of the annuity might reduce the penalties on short-term ownership in the event of death. Still others might consider it important that some

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[2] Proposed Rule 2821(b)(1)(B).

States protect assets held in a variable annuity from attachment by creditors. The possible scenarios are too numerous to consider, which is exactly why a rigid rule is not appropriate. The Proposal unnecessarily eliminates variable annuities as a financial and estate planning option for certain investors, even if the product is otherwise suitable for them based on their overall situation.

Banning sales of annuities to investors who do not have a long-term investment objective also precludes flexible application of the Proposed Rule based on individual product characteristics. The Proposal does not allow for the fact that deferred variable annuity products that exist today – and those that might come to market in the future – could have characteristics that make them appropriate for shorter term investors. Product sponsors could, for example, develop a product to reduce or eliminate surrender charges. The Proposed Rule would stifle such innovations by outlawing sales of the product to an entire market segment, even where the concerns behind the Proposal are not present.

In its current form, the Proposed Rule does not allow for a suitability determination based on each investor's individual needs and circumstances. As such, it places an undue burden on competition and innovation. In banning sales based on an investor's time horizon irrespective of other suitability criteria, the Proposal is not consistent with the investor protection mandate of the securities laws. Accordingly, the Proposal should be amended to remove this provision from the Proposed Rule. Alternatively, "time horizon" should be included as only one piece of information that should be gathered and considered in assessing suitability.

III. The Proposed Disclosure Requirements are Vague and Unworkable

Proposed Rule 2821(b)(1)(A) would require that, before recommending a product, registered representatives have a reasonable basis to believe that that "the customer has been informed of the material features of the deferred variable annuity."[3] Nobody can quarrel with this requirement as a general matter. At a high level, it is consistent with the fundamental basis underlying most securities regulation in the United States – namely, to provide investors disclosure of material facts upon which they can make informed investment decisions. In requiring disclosure, the Proposed Rule recognizes that the customer has an obligation to use information that is provided in connection with the purchase of an annuity.

We have grave concerns, however, about the lack of guidance regarding what must be disclosed, and how the disclosure is supposed to be accomplished. Variable annuities are already subject to a comprehensive disclosure regime, and are also the subject of pending Commission disclosure proposals. Although the Proposal is not specifically framed as a point-of-sale disclosure rule, in fact it mandates some form of disclosure at the point-of-sale, and thus circumvents the Commission's rulemaking on that issue. Moreover, the

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[3] Proposed Rule 2821(b)(1)(A).

Proposed Rule imposes new disclosure requirements without providing any standards whatsoever that a firm can rely upon to ensure that it is in compliance.

A. The Proposal's Disclosure Requirements are Premature: Only the SEC Should Enact Disclosure Rules Regarding Variable Annuities

All of the material features of a variable annuity are described in the product prospectus and supplemental reports that are mandated by the Federal Securities Laws and Commission rules promulgated thereunder. The prospectus is a highly regulated document that has been the subject of extensive rulemaking by the Commission over the years. It is designed to communicate the important information a customer needs to make an investment decision. Product sponsors spend millions of dollars each year complying with securities and insurance regulations that govern in painstaking detail the nature, form and scope of disclosure that must be made concerning the material features of a variable annuity.

To the extent the proposed rule is interpreted as requiring disclosure in addition to the prospectus, the issue the proposal seeks to address appears to be the adequacy of the prospectus as a disclosure document, rather than the sales practices of registered representatives. Every variable annuity purchaser already receives a prospectus, so if investors are not adequately informed it is in large part because: (a) the investors have not availed themselves of information available through the prospectus; or (b) the prospectus does not provide adequate information in a useful form. The unstated intent of the Proposal appears to be to make up for shortcomings in prospectus disclosure by requiring broker-dealers to supplement or "translate" the prospectus for investors.

If the problem is that the prospectus is perceived as not adequately serving its intended purpose, then the Commission should address that issue directly. In fact, the Commission has openly acknowledged issues regarding the usefulness of prospectus disclosure, and has indicated that it intends to undertake a review of the prospectus disclosure requirements.[4]

The Commission – not the NASD – is undoubtedly the appropriate body to conduct that review and adopt appropriate remedial regulations. One of the fundamental underpinnings of effective rulemaking is that regulators should consider alternative solutions that can achieve the desired objectives at a lower cost. Because the NASD does not have jurisdiction over investment companies or prospectus disclosure requirements, it cannot consider viable alternatives to its current proposal that might achieve its objectives more efficiently. Only the Commission has jurisdiction over all of the interested parties

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[4] *See* William H. Donaldson, *Remarks Before the Mutual Fund and Investment Management Conference*, available at www.sec.gov/news/speech/spch031405whd.htm (Mar. 14, 2005) ("I have asked the staff to carry out a top-to-bottom review of the mutual fund disclosure regime and how we can maximize its effectiveness on behalf of fund investors.").

and all available regulatory solutions; accordingly, any revisions to the disclosure regime should be addressed through the Commission's rulemaking process.

The Commission currently has a proposal pending that would address disclosure concerning variable annuities at the point-of-sale. The point-of-sale disclosure proposal has been the subject of extensive comment, and there are significant issues the Commission has yet to resolve concerning the appropriate form and content of that disclosure. To date, the NASD and SEC have not been able to agree as to the appropriate disclosure.

In a recent speech, Commissioner Atkins articulated some of the difficult questions that need to be answered concerning variable annuity disclosure. He noted that:

> Providing investors with clear and concise information is a worthy goal, but the point-of-sale disclosure might not be the place to do it. Would it not make more sense for the Commission to revise existing disclosures rather than adding a new layer of disclosures? Do we run the risk of confusing investors with multiple, overlapping disclosure documents? If comprehensive information is what investors want, we should undertake a comprehensive look at disclosure for mutual funds and related products.[5]

The Proposed Rule avoids – rather than resolves – these important questions concerning the appropriate form and content of point-of-sale disclosure.

The Commission's rulemaking process is the proper forum for implementing any changes to the disclosure requirements concerning variable annuities. The Proposed Rule prematurely imposes requirements that may be duplicative, or even inconsistent, with any rule the Commission eventually decides to adopt. If the prospectus is not considered adequate, then the Commission would best serve investors by revisiting the prospectus and point-of-sale disclosure requirements, and adopting rules to provide the necessary information in a consistent manner across the industry.

B. The Proposed Rule Does Not Provide Any Standards to Govern the Required Disclosures

To the extent the Proposal requires additional disclosure beyond the prospectus, it should say so explicitly and provide clear standards as to what is required. The Proposal requires firms and representatives to have a reasonable basis to believe that a customer has been informed about all material features of a deferred variable annuity, but it provides no guidance whatsoever regarding how disclosure of that information should be accomplished. In this regard, the Proposal indicates that broker-dealers are on their own

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[5] Paul S. Atkins, *Remarks Before the National Association for Variable Annuities*, available at www.sec.gov/news/speech/spch062805psa.htm (June 28, 2005).

to figure out what is required because the Proposed Rule does "not prescribe the specific form of disclosure."

In failing to address this issue, the Proposal fails to provide guidance on two important points that all disclosure rules should address: (a) the form (*i.e.*, written or oral); and (b) the content (*i.e.*, what is required to be disclosed). It thus puts firms in the untenable position of being second-guessed concerning the adequacy of their disclosure, regardless of how or how much disclosure is actually made.

Moreover, even though the Proposed Rule does not by its terms require written disclosure, as a practical matter most firms will be forced to reduce their disclosures to writing. Written disclosure will be necessary to reduce inevitable discrepancies about what was, in fact, disclosed, and to manage the risks associated with trying to comply with the Proposal's vague mandate. An unintended (though predictable) consequence of the Proposal will be that firms that distribute variable annuities will have to enlist lawyers to interpret what the "material features" of a variable annuity are, and assist in designing a disclosure document.

From a cost perspective, the Proposal's disclosure mandate cannot be justified. Rather than requiring a standardized disclosure from a single product sponsor (which, as noted above, is not something the NASD can require), the Proposed Rule would put the burden on thousands of individual firms that offer variable annuities. Every broker-dealer will have to come up with its own individual disclosure solution, greatly increasing the cost of implementing the rule. Moreover, because variable annuity contracts each have unique characteristics, each firm will further have to come up with an individualized disclosure tailored to every contract it offers. In the case of H.D. Vest, that could mean developing over a hundred product-specific disclosure documents that would have to be updated on an ongoing basis. That is an inefficient and unworkable way to provide disclosure.

The significant costs associated with this requirement will likely cause firms to reduce the number of contracts they offer, thereby reducing investor choice. In addition to the substantial costs, this regulatory regime will lead to customers receiving fragmented and inconsistent disclosure based on what each individual firm decides to disclose. This is contrary to the whole system of standardizing and consolidating important information in the prospectus. If there are important features of a deferred variable annuity that warrant disclosure, that disclosure should be mandated on a standardized basis from the product sponsor.

The Proposal's disclosure framework stands in contrast to the Commission's adoption of the mutual fund "Profile."[6] The Profile allows mutual funds to provide investors a summary of key information about the fund, which is then followed up with a prospectus at or before delivery of the transaction confirmation. In that rulemaking, the Commission

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[6] *See New Disclosure Option for Open-End Management Investment Companies*, Release No. 33-7513 (Mar. 13, 1998).

provided detailed guidance regarding the information that funds are required or permitted to disclose. The Commission also explicitly addressed concerns that providing a summary could lead to liability for omitting material information contained in the prospectus. The Commission noted that "a fund using a profile generally should not face liability for omitting information included in the fund's prospectus if the profile includes the information required or permitted by" the rule.[7] The Commission thus provided clear standards, and some comfort that companies that attempted in good faith to meet those standards would not be subject to liability.

On the contrary, under the Proposed Rule, even firms that incur significant legal and compliance costs in an effort to comply in good faith with the disclosure requirements will have no comfort that they are complying with the rule. In the absence of clear rule-based guidance, the standards governing the required content of the disclosure, and what constitutes a "reasonable" belief that a customer has been informed, are likely be set retroactively through enforcement proceedings. In addition, plaintiffs' lawyers are likely to rely on the rule as providing a cause of action for inadequate disclosure even if a prospectus is delivered. Those charges will be difficult to defend when they are applied in hindsight and in the absence of any clear standards as to what was required in the first place. As was done in connection with the Fund Profile rulemaking, such ambiguities should be resolved before the Proposed Rule is approved.

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In conclusion, we agree with the Proposal's overarching goal of improving sales practices and disclosure concerning deferred variable annuities. However, for the reasons stated above, we do not believe that the Proposed Rule should be approved in its current form.

Sincerely,

Roger C. Ochs
President

H.D. Vest, Inc.

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[7] *Id.*