SUTHERLAND

1275 Pennsylvania Avenue, NW
Washington, DC 20004-2415
202.383.0100 Fax 202.637.3593
www.sutherland.com

ATLANTA
AUSTIN
HOUSTON
NEW YORK
TALLAHASSEE
WASHINGTON DC

**VIA EMAIL**

June 13, 2008

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

**Re: Regulatory Notice 08-24, Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls**

Dear Ms. Asquith:

The Committee of Annuity Insurers ("CAI")[1] submits this comment letter in response to FINRA's request for comment on the above-referenced proposal.

**BACKGROUND ON PROPOSED AMENDMENTS**

FINRA proposes new FINRA Rules 3110 and 3120 regarding supervision and supervisory controls, respectively. As pertains to our discussion here, the proposals would make certain substantive changes to the requirements of NASD Rules 3010, 3012 and 3040.

**Proposed FINRA Rule 3110.** Rule 3110 would set forth requirements relating to a firm's supervisory system, written procedures, and internal inspections. The rule would be accompanied by Supplementary Material that would include provisions from NASD Rule 3010 as well as additional guidance. Some of the proposed changes include:

- A firm would be required to designate an appropriately registered principal(s) with authority to supervise each type of business in which the member engages, whether or not such activity would require broker-dealer registration;

[1] The Committee of Annuity Insurers is a coalition of 33 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over two-thirds of the annuity business in the United States. A list of the Committee members is attached at Appendix A.

- A firm would be required to have supervisory procedures that require a registered principal to review all transactions relating to the firm's investment banking or securities business; and
- Replacing NASD Rule 3040 with a requirement to supervise all approved outside "investment banking or securities business," regardless of whether or not the registered representative receives "selling compensation."

**Proposed FINRA Rule 3120.** Proposed FINRA Rule 3120 would replace NASD Rule 3012. In contrast to the current requirements, the annual report to management would be required to include certain additional information (*e.g.*, customer complaints and discussion of compliance with respect to various activities) if the member has reported gross revenue of at least $150 million on its FOCUS reports in the prior calendar year.

**COMMENTS**

**1. Supervision of Outside Securities Activities.**

Proposed Rule 3110(b)(3)(A) would provide:

> Unless a member provides prior written approval, no associated person may conduct any investment banking or ***securities business*** outside the scope of the member's business. If the member gives such written approval, such activity is within the scope of the member's business and shall be supervised in accordance with this Rule, subject to the exceptions set forth in subparagraph (B). (Emphasis Added.)

According to Regulatory Notice 08-24, the proposed change is intended to streamline the standards set forth in NASD Rule 3040. The Committee notes that the scope of the proposed rule differs materially from Rule 3040: executing a private securities transaction was the trigger for applicability of Rule 3040; the proposed rule would apparently broaden the scope to include "any investment banking or securities business." Neither the proposal nor the Regulatory Notice offer an express definition of "investment banking or securities business" nor do they suggest examples of what such business does and does not include. Given the uncertainty regarding this important phrase, there seems to be a risk that adopting the proposed rule would result in an unintended expansion of firms' responsibility for outside activities.

This issue is of particular concern for broker-dealers whose registered representatives may engage in certain outside activities, including providing investment advisory services through registered investment advisers. We request that FINRA clarify that the proposed rule will not serve to modify prior guidance in this area. Specifically, we ask that FINRA reaffirm the guidance set forth in NASD Notice to Members 94-44 and 96-33. These Notices establish well-accepted standards under NASD Rules 3030 and Rule 3040, pursuant to which firms supervise the *transaction-related* activities that follow from a registered representatives investment advisory activities, as opposed to advisory

activity that merely lead to securities transactions. This is an important distinction on which firms have relied in establishing their supervisory programs. No rationale appears to have been advanced for departing from this reasonable and judicious approach to this sometimes complicated issue.

**2. Designation of an appropriately registered principal with respect to each type of business in which a firm engages.**

For a number of reasons, the Committee urges that FINRA return to the standard requiring the designation of a registered principal with respect to those requirements for which registration of a broker-dealer is required. First, we are unclear on whether FINRA has jurisdiction to require a registered principal to be appointed to oversee activities that do not require registration. Second, we are greatly concerned about the potential for FINRA to create substantive requirements with respect to non-securities related businesses which already fall under the jurisdiction of other regulatory authorities. We also note that the proposal is inconsistent with current efforts to modernize financial regulation rather than create additional, unnecessary regulatory layers. Third, the Committee has significant concerns about the ability to provide any meaningful guidance to, or standards to judge, supervisors overseeing non-securities related business. Fourth, the Committee believes it may be very difficult in practice to determine whether a particular activity is conducted through the member firm, or through affiliated (and in many cases highly regulated) companies of the member firm. The Committee urges FINRA to reconsider this aspect of the proposal in light of the above, as well as the enormous breadth of activities that arguably would be made subject to FINRA regulation under the proposal.

**3. Insider Trading**

Proposed Supplementary Material .08 would require that a member include in its supervisory procedures a process for the review of its securities transactions that are effective for the accounts of the member and/or the member's associated persons and their family members to identify trades that may violate the provisions of the Securities Exchange Act of 1934 (the "Exchange Act"), the rules thereunder, or FINRA rules prohibiting insider trading and manipulative and deceptive devices. A firm would further be required to conduct promptly an internal investigation into any such trade to determine whether a violation of those laws or rules has occurred.

These provisions stand in stark contrast to the flexibility provided by Section 15(f) of the Exchange Act which requires every registered broker or dealer to establish, maintain, and enforce written policies and procedures **reasonably designed, taking into consideration the nature of the broker or dealer's business**, to prevent the misuse of material nonpublic information by such broker or dealer or any person associated with such broker or dealer. There appears to be no basis for FINRA suggesting this broad departure from longstanding SEC practice in this area.

The Committee urges that this provision be revised in a manner to be consistent with the Exchange Act's provision which permits a reasonableness standard.

**4. Office Inspections**

Proposed FINRA Rule 3110(c) would seek to avoid conflicts with respect to internal inspections. The rule would require that each member have procedures reasonably designed to, among other things, "ensure that the person conducting an inspection... is not an associated person assigned to the location or is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to the location." This provision is written in a confusing manner and we request that it be revised to provide firms with the flexibility to design their own polices and procedures which serve to adequately safeguard their inspection system from conflicts of interests, including those that may arise when the branch manager and person conducting the inspection report to the same person.

**5. Negative Presumptions- Supplementary Material .15 and .04**

The proposal appears to create a "negative presumption" where the exam cycle for a location is less frequent than every three years (Supplementary Material .15) and where a single prinicpal supervises two or more 2 OSJs (Supplementary Material .04). The Committee asks that these provisions be stated as considerations and not as negative presumptions.

**6. Supervisory Controls**

As noted, proposed FINRA Rule 3120 would replace NASD Rule 3012. In contrast to the current requirements, the annual report to management would be required to include certain additional information (*e.g.,* customer complaints and discussion of compliance with respect to various activities) if the member has reported gross revenue of at least $150 million on its FOCUS reports in the prior calendar year.

The Committee believes that this provision is unnecessary and would urge a return to the principles-based approach underlying Rule 3012.

**CONCLUSION**

The Committee appreciates the opportunity to comment on proposed Rules 3110 and 3120. The Committee welcomes any questions you may have about the comments identified in this letter.

Respectfully Submitted,

SUTHERLAND ASBILL & BRENNAN LLP

By: Cliff Kirsch EAA
Clifford E. Kirsch

By: Eric A. Arnold
Eric A. Arnold

APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

AEGON USA, Inc.
Allstate Financial
AIG Life Insurance Companies
AmerUs Annuity Group Co.
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
Conseco, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Life Insurance Company of the Southwest
Lincoln Financial Group
MassMutual Financial Group
Merrill Lynch Life Insurance Company
Metropolitan Life Insurance Company
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Old Mutual Life Insurance Company
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
RiverSource Life Insurance Company
*(an Ameriprise Financial company)*
Sun Life Financial
Symetra Financial
The Phoenix Life Insurance Company
USAA Life Insurance Company