

February 20, 2009

**VIA EMAIL**

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

**Re: FINRA Regulatory Notice 09-03, Financial  
Responsibility and Related Operational Rules**

Dear Ms. Asquith:

This letter is submitted on behalf of the Committee of Annuity Insurers (“Committee”) in response to FINRA’s publication of and request for comments on Regulatory Notice 09-03 (“Notice 09-03”).<sup>1</sup> The Committee appreciates FINRA’s continuing efforts to consolidate NASD and NYSE rules and adopt efficient and effective rules for all member firms. The Committee also appreciates FINRA’s solicitation of member firm comments and its efforts to respond to those comments before adopting new rules.

Our comments begin with a discussion of the proposed definition of “carrying or clearing” firm and then discuss each proposed rule individually.

**The Definition of “Carrying or Clearing” Firm**

The rules proposed in Notice 09-03, and other FINRA proposed financial and operational rules,<sup>2</sup> divide member firms into two categories for some but not all purposes. Although not specifically stated in Notice 09-03, firms that are classified as “carrying or clearing”

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<sup>1</sup> The Committee of Annuity Insurers is a coalition of 30 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 Committee members is attached at Appendix A.

<sup>2</sup> See FINRA’s Notice of Filing of Proposed Rule Change to Adopt Rules Governing Financial Responsibility in the Consolidated FINRA Rulebook, SEC Release No. 34-59273, 74 Fed. Reg. 4992 (Jan. 28, 2009), wherein FINRA proposes: to adopt FINRA Rules 4110, 4120, 4130, 4140, and 4521; to revise FINRA Rules 9557 and 9559; and to make conforming changes to Schedule A to the FINRA By-Laws.

firms will have more responsibilities under the proposed rules than non-carrying and non-clearing firms because of the different functions and risk profiles of the two types of firms. For example, under the proposed rules FINRA can require carrying and clearing members to maintain greater net capital or net worth than is required by the SEC's Net Capital Rule;<sup>3</sup> FINRA can prohibit carrying and clearing firms from withdrawing capital in excess of 10 percent of a firm's excess net capital without FINRA's prior consent,<sup>4</sup> and carrying and clearing firms generally would be required to create and keep additional books and records.<sup>5</sup>

The distinction FINRA proposes to make between carrying and clearing firms and non-carrying and clearing firms was first introduced in FINRA Regulatory Notice 08-23 ("Notice 08-23").<sup>6</sup> In that notice, FINRA stated that certain of its proposed rule provisions would apply only to those firms that clear or carry customer accounts or that operate pursuant to the exemptive provisions of Securities Exchange Act Rule 15c3-3(k)(2)(i). FINRA also stated that rules applicable to carrying, clearing and (k)(2)(i) firms would not apply to introducing firms or to firms with limited business models (together, FINRA defined such firms as "non-clearing firms"). In a parenthetical, FINRA explained that introducing firms and firms that engage exclusively in subscription-basis mutual fund transactions, direct participation programs, or mergers and acquisitions activities would not be subject to rules applicable to carrying, clearing and (k)(2)(i) firms.<sup>7</sup>

In response to the publication of Notice 08-23, the Committee submitted a comment letter to FINRA wherein, among other things, the Committee questioned why member firms that rely on the (k)(2)(i) exemption should be subject to the same rules as carrying and clearing firms and pointed out that the risks generated by the activities of a (k)(2)(i) firm can be significantly different from those of carrying and clearing firms.<sup>8</sup> Other commenters also questioned why member firms that rely on the (k)(2)(i) exemption should be subject to the same rules as carrying and clearing firms even though some (k)(2)(i) member firms do not engage in carrying or

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<sup>3</sup> See SEC Rule 15c3-1 and Proposed FINRA Rule 4110 in SEC Release No. 34-59273, *supra* note 2.

<sup>4</sup> See Proposed FINRA Rule 4110.

<sup>5</sup> *Id.*

<sup>6</sup> Regulatory Notice 08-23 (May 2008); the rules discussed in Notice 08-23 were subsequently filed with the SEC and published by the SEC for comment in Release No. 34-59273. The Committee's comments herein with respect to the use of the term "carrying or clearing" firm have also been submitted to the SEC in response to Release No. 34-59273. See letter submitted by Sutherland Asbill & Brennan LLP on behalf of the Committee of Annuity Insurers, dated February 18, 2009.

<sup>7</sup> See also SEC Release No. 34-59273, *supra* note 2, at notes 7 and 9.

<sup>8</sup> See letter submitted by Sutherland on behalf of the Committee of Annuity Insurers in response to Notice 08-23, dated June 13, 2008, available at <http://www.finra.org/Industry/Regulation/Notices/2008/P038501>.

clearing activities.<sup>9</sup> The Committee also asked for clarification regarding when a firm might be deemed to be a (k)(2)(i) member.

FINRA, in response to comments it received on Notice 08-23, stated that a (k)(2)(i) firm would be included as a clearing or carrying member for purposes of the proposed rules if the firm either holds customer funds in a bank account established pursuant to Rule 15c3-3(k)(2)(i) or clears customer transactions through such an account.<sup>10</sup> FINRA has not explained its rationale, however, for concluding that all (k)(2)(i) members present a risk profile comparable to that of traditional carrying and clearing firms, *i.e.*, firms that do not rely on any of the paragraph (k) exemptions from Rule 15c3-3.

We want to emphasize that the Committee appreciates FINRA's efforts to draw meaningful distinctions among the different types of firms it regulates. These distinctions are extremely important for many reasons, including the fact that they assist FINRA in identifying business models that increase the risk of loss of customer assets or other customer harm. The Committee fully supports FINRA's efforts in this regard.

The Committee believes, however, that FINRA's definition of "carrying or clearing" firm should be revised in two respects.

First, we request that FINRA include firms distributing variable annuities or life insurance ("variable products") in the capacity of principal underwriters, wholesalers or selling firms within the types of firms FINRA has described as having "limited business models." Firms distributing variable products are, like mutual fund distributors, operating limited business models, and these models are markedly different than the models employed by traditional clearing and carrying firms. Like mutual fund distributors, distributors of variable products typically require that customers make their checks payable to the issuer, not the introducing firm.<sup>11</sup> Accordingly, FINRA's reference to firms with limited business models should include variable product distributors.

Second, the Committee believes that FINRA should take into consideration the extremely different profile of firms that use the exemption provided in SEC Rule 15c3-3(k)(2)(i) versus the profile of traditional carrying and clearing firms. A firm that uses the (k)(2)(i) exemption by definition is complying with the SEC's "prompt" forwarding requirement, which requires such

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<sup>9</sup> See, e.g., letter submitted by ING Advisors Network noting that (k)(2)(i) firms have a reduced operating risk (June 13, 2008); and letter from Stephen R. Kinkade, questioning FINRA's rationale for including (k)(2)(i) firms in the same tier as carrying and clearing firms (June 13, 2008). Both letters are available at: [www.finra.org/Industry/Regulation/Notices/2008/P038501](http://www.finra.org/Industry/Regulation/Notices/2008/P038501).

<sup>10</sup> See SEC Release No. 34-59273 at 74 Fed. Reg. 4997.

<sup>11</sup> Introducing firms that sell variable products (like mutual fund distributors) use the "check and application" business model and do not typically deposit customer funds into segregated accounts established for a customer's benefit.

firms to forward customer funds and securities by noon of the next business day following receipt. To the extent such firms actually hold customer funds in a Special Account For the Exclusive Benefit of Customers, the amounts so held, and the duration of the holding, is unlikely to be comparable to the amounts held by traditional carrying and clearing firms. FINRA has indicated that there are seventy firms that come within the (k)(2)(i) exemption; we would be interested in learning from FINRA what its data shows with respect to the amount of customer money held by such firms in their Special Accounts and the duration of the holding period. We believe this data would be helpful in assessing the appropriateness of treating all (k)(2)(i) firms in the same manner as carrying and clearing firms.

**Proposed Rule 4150 (Guarantees by, or Flow Through Benefits for, Members)**

Proposed Rule 4150 would require FINRA members to provide written notice to FINRA at least 10 business days in advance of entering into any arrangement or relationship pursuant to which any FINRA member guarantees, endorses or assumes, directly or indirectly, the obligations or liabilities of another person, or receives flow through capital benefits under the SEC's Net Capital Rule. First, the Committee requests that FINRA clarify the meaning of the word "obligation." We assume but would like to be certain that the rule's requirements are intended to capture *financial obligations*, but are not meant to cover contractual obligations that are not financial. In this regard the Committee would like FINRA to confirm that the proposed rule does not apply to insurance company issuers and their principal underwriters insofar as these entities engage in normal transaction processing and customer communication activities for and or behalf of each other, which obligations are typically evidenced in a distribution agreement.<sup>12</sup>

Second, the Committee would like to understand what impact, if any, Proposed Rule 4150 would have on expense sharing agreements. If a firm files or has previously filed its expense sharing agreement(s) with FINRA, would it have a new or separate obligation under Proposed Rule 4150 to provide written notice to FINRA of the arrangements covered by the proposed rule?

Third, it would seem appropriate for Rule 4150 to contain an exemption from the rule for guarantees that are already subject to review by another regulator. As you are aware, FINRA member firms may be required to submit certain financial arrangements to regulators other than FINRA in advance of the effectiveness of those arrangements. For example, a member firm whose parent is a bank holding company or a financial holding company, whose financial arrangements are subject to review by a federal bank regulator, may find itself subject to multiple federal regulations if the member wants to enter into financial arrangements subject to the proposed rule. If a regulator comparable to FINRA has already reviewed a financial

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<sup>12</sup> In this regard *see* SEC Release No. 34-8389, wherein the SEC describes the relationship between issuers of variable products and their distributors.

arrangement, requiring that member firm to give advance notice of the arrangement to FINRA may be duplicative.

**Proposed Rule 4311 (Carrying Agreements)**

Proposed Rule 4311 would, among other things, require clearing firms to conduct due diligence on each of their introducing firms. The Committee requests that FINRA make clear that a clearing firm's obligation in this regard extends only to pertinent history (for example, complaint and disciplinary information) of the introducing firm that receives the clearing services, and does not extend to affiliates of the introducing firm. We also request that FINRA make clear that any information an introducing firm provides to a clearing firm as part of a due diligence review be kept confidential by the clearing firm.

**Proposed Rule 4522 (Periodic Security Counts, Verifications and Comparisons)**

The Committee requests that FINRA confirm that member firms that are exempt from SEC Rule 17a-13 would not be subject to Rule 4522, notwithstanding that such firms may meet FINRA's proposed definition of "carrying or clearing firm."

**Proposed Rule 4523 (Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts)**

Proposed Rule 4523 would require broker-dealers to identify to FINRA specific persons who are responsible for ensuring the accuracy of suspense account records and moving items whose disposition is unclear to a suspense account. Broker-dealers would be required to keep a record "of all information known with respect to each item so recorded." The proposed rule also would require each member to designate an individual responsible for "each general ledger bookkeeping account ...."

The Committee wants to ensure that the supervisory obligation established in the rule provides member firms with the flexibility they need to efficiently manage their businesses. Under Proposed Rule 4523(a), persons who would be named as responsible for each general ledger bookkeeping account and who must "control and oversee" entries into each such account, must be able to delegate responsibility for making entries into the various accounts - in other words, supervisors are not generally charged with making line-by-line entries. The person named as the responsible person under 4523(a) must be able to rely on reasonable procedures when he or she makes the determination (called for by the proposed rule) that an account is "current and accurate." We believe the concept of reasonable supervision and policies and procedures reasonably designed to achieve compliance with the rule should be reflected in the rule text.

We also want to comment on a requirement in 4523(a) that the identified responsible person "determine at all times" that the account is current and accurate. The phrase "at all times" should be stricken from the rule. A firm should be permitted to adopt reasonable policies and procedures with respect to the timing of the functions performed by the responsible person.

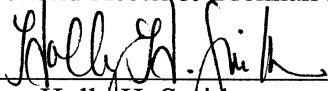
The Committee also requests that FINRA confirm that the proposed rule would not apply to accounts that insurance companies may establish under NASD Rule 2821, i.e., accounts not held at a broker-dealer. We also think it would be helpful if FINRA identifies the specific general ledger accounts intended to be covered by the rule, e.g., the rule applies to asset and liability accounts and does not apply to revenue and expense accounts.

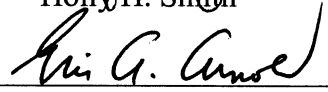
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On behalf of the Committee, we appreciate the opportunity to comment on the proposed rules. If you have any questions regarding these comments please feel free to contact the undersigned at (202) 383-0100.

Sincerely,

Sutherland Asbill & Brennan LLP

By:   
Holly H. Smith

By:   
Eric A. Arnold

For The Committee of Annuity Insurers

## APPENDIX A

AEGON Group of Companies  
Allstate Financial  
AVIVA USA Corporation  
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  
Metropolitan Life Insurance Company  
Nationwide Life Insurance Companies  
New York Life Insurance Company  
Northwestern Mutual Life Insurance Company  
Ohio National Financial Services  
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  
USAA Life Insurance Company