Financial Industry Regulatory Authority

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Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR-FINRA-2008-067 – Response to Comments

Dear Ms. Murphy:

This letter responds to comments submitted to the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing,[1] a proposed rule change to adopt FINRA Rules 4110, 4120, 4130, 4140 and 4521 (the "proposed rules") in the consolidated FINRA rulebook ("Consolidated FINRA Rulebook") and, among others, to revise FINRA Rules 9557 and 9559. The Commission received one comment in response to the proposal.[2]

Carrying and Clearing Firms

FINRA has explained that many provisions of the proposed rules are tiered to apply only to those firms that carry or clear customer accounts.[3] FINRA stated in the rule filing that all requirements that would apply to firms that carry or clear customer accounts would also apply to firms that operate pursuant to the exemptive provisions of Securities Exchange Act ("SEA") Rule 15c3-3(k)(2)(i).[4] FINRA further clarified that those

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1 See Securities Exchange Act Release No. 59273 (January 22, 2009), 74 FR 4992 (January 28, 2009) (Notice of Filing of Proposed Rule Change; File No. SR-FINRA-2008-067) (the "rule filing").

2 Letter to Elizabeth M. Murphy from Holly H. Smith and Eric A. Arnold, Sutherland Asbill & Brennan LLP on behalf of the Committee of Annuity Insurers ("CAI") dated February 18, 2009.

3 See 74 FR 4993.

4 FINRA explained that "operating" pursuant to the exemptive provisions of Rule 15c3-3(k)(2)(i) is not meant to include firms that have *elected* the exemption but do not operate as such. A firm operates pursuant to the exemptive provisions of Rule

requirements that would apply only to carrying and clearing firms would not apply to introducing firms or to certain firms with limited business models (together referred to as "non-clearing firms"; for example, firms that engage exclusively in subscription-basis mutual fund transactions, direct participation programs, or mergers and acquisitions activities.[5]

CAI suggests that certain firms – those distributing variable annuities or life insurance in the capacity of principal underwriters, wholesalers or selling firms – should be included within the types of members that FINRA describes as having limited business models because they typically require customers to make their checks payable to the issuer, not the member, and because the customers' funds are typically not deposited into segregated accounts established for the customers' benefit.

In response, FINRA believes that CAI misinterprets the purpose of FINRA's reference in the rule filing to limited business models. FINRA mentioned such business models solely to provide examples of business activities that FINRA believes do not involve carrying or clearing customer accounts or operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i). It is not FINRA's intention to create business model or other exemptions from the proposed rules. Rather, the FINRA rule filing is clear by its terms as to the functional activities that the proposed rules are intended to reach. If a firm engages in *any* carrying or clearing activity, including operating pursuant to the exemptive provisions of Rule 15c3-3(k)(2)(i), then such firm would be expected to comply with all requirements set forth in the proposed rules that apply to carrying or clearing firms. A firm that does not engage in any such activity would not be subject to those requirements.

CAI suggests that because firms that operate pursuant to the Rule 15c3-3(k)(2)(i) exemption promptly forward customer funds and securities, they should not be subject to the same requirements as carrying or clearing firms. CAI further suggests that FINRA should explain the data upon which it relies as the basis for the proposed regulatory treatment of firms that operate pursuant to the Rule 15c3-3(k)(2)(i) exemption.

In response, FINRA disagrees with CAI's suggestion that firms that operate pursuant to the Rule 15c3-3(k)(2)(i) exemption should not be subject to the same requirements as carrying or clearing firms under the proposed rules. FINRA notes that firms that operate pursuant to the Rule 15c3-3(k)(2)(i) exemption receive customer funds for the purpose of settling customer transactions. Such firms perform a clearing function, irrespective of how short the period they may hold customer funds. Accordingly, FINRA believes that firms that operate pursuant to the Rule 15c3-3(k)(2)(i) exemption should, as a

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15c3-3(k)(2)(i) if it either holds customer funds in a bank account established pursuant to the SEA rule or clears customer transactions through such an account. See 74 FR 4997.

5 See 74 FR 4993.

matter of investor protection, be subject to all requirements set forth in the proposed rules that apply to carrying and clearing firms.

Proposed FINRA Rule 4110

CAI suggests that FINRA should specify objective standards as to when FINRA would, for the protection of investors or in the public interest, exercise its authority pursuant to Proposed FINRA Rule 4110(a) to prescribe greater net capital or net worth requirements. As FINRA explained in the rule filing in response to other commenters that made similar suggestions, Proposed FINRA Rule 4110(a) does not lend itself to prescribed parameters such as suggested by CAI.[6] The proposed rule is intended to enable FINRA to respond promptly to extraordinary, unanticipated or emergency circumstances. FINRA does not agree that it is in the public interest to limit the proposed rule's application by listing specific circumstances or standards under which FINRA would exercise its authority.

CAI requests that FINRA specify with certainty the amount of time within which FINRA would act on requests for withdrawals that exceed 10 percent of excess net capital.[7] FINRA addressed this issue in the rule filing in response to other commenters when it explained that requests for withdrawals can be handled in a routine manner and that decisions typically would be issued in approximately three business days.[8] CAI inquires whether FINRA's review of requests for withdrawal would be based on capital calculated as of the date when the request is filed, or whether FINRA would require a firm to recompute capital while the request is pending. Again, FINRA addressed this issue in the rule filing. With respect to the requirements of Proposed FINRA Rule 4110(c)(2), FINRA explained that the calculation of 10 percent of excess net capital must be based on the member's excess net capital position as reported in its most recently filed Form X-17A-5.[9] FINRA stated that the member must assure itself that the excess net capital so reported has not materially changed since the time the form was filed. Finally, CAI suggests that FINRA's proposed rule is a significant departure from existing SEC rules and questions why FINRA would need such a requirement. In response, FINRA notes that its mandate is to design and enforce rules to ensure investor protection. As FINRA explained in the rule filing, regulation of withdrawal of equity capital serves to promote the financial stability of member firms and, accordingly, is an important element of investor protection.[10]

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6 See 74 FR 4997.

7 See Proposed FINRA Rule 4110(c)(2) at 74 FR 5000.

8 See 74 FR 4998.

9 See note 13 at 74 FR 4994.

10 See 74 FR 4994.

CAI suggests that Proposed FINRA Rule 4110(b) should be revised in light of SEA Rule 17a-11. In response, as stated in the rule filing, the requirements set forth in the proposed rule are consistent with current law.[11] Further, the Commission noted in this connection that the net capital rule requires that "every broker or dealer shall at all times have and maintain" certain specified levels of net capital.[12] The Commission noted that to the extent a broker-dealer fails to maintain at least the amount of net capital specified in that rule, it must cease doing a securities business. CAI suggests that the rules should take into account whether a firm's net capital violation is a continuing condition. In response to CAI's concern, FINRA notes that the firm's obligations, both under the current regulatory framework and under the proposed rules, are clear – the firm must maintain the required net capital at all times. If the firm's net capital violation is not corrected, it must cease operation. The firm may resume its business when it returns to net capital compliance.

Proposed FINRA Rule 9559

Proposed FINRA Rule 9559(h) would require, among others, that not less than two business days before the hearing in an action brought under Proposed FINRA Rule 9557, FINRA staff shall provide to the respondent who requested the hearing, by facsimile or overnight courier, all documents that were considered in issuing the notice pursuant to Rule 9557 ("Rule 9557 notice"), unless a document meets the criteria of FINRA Rule 9251(b)(1)(A), (B) or (C). CAI suggests that documents should be provided to the respondent as soon as the hearing is requested because not doing so puts the respondent at a disadvantage. FINRA disagrees. The document delivery requirement as set forth in the proposed rule is reasonable given that the hearing must take place within five business days of when the respondent files the written hearing request.[13] Further, irrespective of document delivery, the proposed rule ensures that a respondent would be fully informed of the factual basis of the action. Proposed FINRA Rule 9557(c) provides that the Rule 9557 notice must set forth, among others, the specific grounds and the factual basis for the FINRA action and the conditions for complying with and, where applicable, avoiding or terminating the requirements and/or restrictions imposed by the notice.[14]

Proposed FINRA Rule 9559(n) provides that in an action brought pursuant to Proposed FINRA Rule 9557, the Hearing Panel shall approve or withdraw the requirements and/or restrictions imposed by the Rule 9557 notice.[15] CAI suggests that the Hearing Panel

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11 See 74 FR 4993 through 4994.

12 See note 10 at 74 FR 4994.

13 See Proposed FINRA Rule 9559(f)(1) at 74 FR 5005.

14 See Proposed FINRA Rule 9557 at 74 FR 5002 through 5004.

15 See 74 FR 5005.

should have authority to modify such requirements and/or restrictions. FINRA again disagrees. Consistent with the goal of providing the respondent an expedited resolution of the action, the proposed rule vests authority to remove or reduce the requirements and/or restrictions imposed by the notice with FINRA staff.[16] FINRA notes that, if the respondent requests a hearing, the proposed rule permits him or her to contest, in part, the validity of the requirements and/or restrictions imposed by the notice.[17] FINRA believes that authorizing the Hearing Panel, apart from action by FINRA staff, to modify the requirements and/or restrictions imposed by a Rule 9557 notice would not be conducive to the efficient and expedited resolution of the action.

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FINRA believes that the foregoing responds to the material issues raised by the commenter to this rule filing. If you have any questions, please contact me at (202) 728-6961; email: adam.arkel@finra.org. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Adam H. Arkel
Assistant General Counsel

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16 See Proposed FINRA Rule 9557(e) at 74 FR 5003.

17 See id.