SUTHERLAND

SUTHERLAND ASBILL & BRENNAN LLP
700 Sixth Street, NW, Suite 700
Washington, DC 20001-3980
202.383.0100 Fax 202.637.3593
www.sutherland.com

July 29, 2013

VIA E-MAIL

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

Re: File No. SR-FINRA-2013-025
Notice of Filing of Proposed Rule Change to Adopt Rules Regarding Supervision in the Consolidated FINRA Rulebook

Dear Ms. Murphy:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),[1] in response to the *Notice of Filing of Proposed Rule Change to Adopt Rules Regarding Supervision in the Consolidated FINRA Rulebook* ("Proposal Notice") issued by the U.S. Securities and Exchange Commission (the "SEC") on July 1, 2013.[2]

OVERVIEW OF PROPOSED RULE CHANGES

The Proposal Notice solicits comment on rule changes (the "Proposed Rule Change(s)") to, among other rules, NASD Rule 3010 (the supervision rule) and NASD Rule 3012 (the supervisory controls rule) proposed by the Financial Industry Regulatory Authority, Inc. ("FINRA") as part of the FINRA Consolidated Rulebook. The Proposal Notice would adopt proposed FINRA Rule 3110 ("FINRA Rule 3110") to replace NASD Rule 3010, and proposed

[1] The Committee of Annuity Insurers is a coalition of 28 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1982 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A. Committee members typically have one or in many cases several affiliated broker-dealers that are engaged in the distribution of annuity products. Together these broker-dealers represent a sizeable portion of the brokerage industry. In some cases, the broker-dealer activity is limited to acting as a principal underwriter of variable annuities. In many other cases, however, member broker-dealers engage in retail sales activity. Such activity generally involves the sale of annuities and other insurance products as well as mutual funds and 529 plans. They generally clear their securities business on a fully disclosed basis. Committee member broker-dealers engaged in retail sales activity are often dually-registered as investment advisers or affiliated with registered investment advisers, and their registered representatives may also provide advisory services through independently-owned investment advisers. Registered representatives of Committee broker-dealers are dually-licensed as insurance agents in connection with their sales of insurance products.

[2] The Proposal Notice was published in SEC Release No. 34-69902, 78 Fed. Reg. 40792 (July 8, 2013).

FINRA Rule 3120 ("FINRA Rule 3120") to replace NASD Rule 3012. In addition new FINRA Rule 3150 would set forth requirements related to the holding of customer mail and new FINRA Rule 3170 would govern tape recording of registered persons by certain firms.

FINRA Rule 3110 would set forth requirements relating to a firm's :

- Supervisory system (3110(a))
- Written procedures (3110(b))
- Internal inspections (3110(c))
- Transaction review and investigations (3110(d))
- Definitions of "Office of Supervisory Jurisdiction" and "Branch Office" (3110(e))

FINRA Rule 3110 would be accompanied by Supplementary Material ("SM(s)") that would include many provisions from NASD Rule 3010 as well as additional guidance.

BACKGROUND ON THE PROPOSED RULE CHANGES

The Proposed Rule Changes address a very wide array of provisions that establish the fundamental supervisory obligations of member firms with respect to their securities business, and also include proposed new "stand alone" rules to address holding customer mail and "taping" activities required for certain firms. The Committee notes that the Proposed Rule Changes have been subject to more than 5 years of development. The Proposal Notice sets forth the Proposed Rule Changes that were first exposed to member firms by FINRA through a 2008 Regulatory Notice.[3] The NASD rules impacted under RN 08-24 were among the very first rules subject to revision under FINRA's rulebook consolidation project. FINRA eventually filed the rule changes with the SEC on June 23, 2011.[4] The filing was then withdrawn by FINRA in the Fall of 2011.[5] About 20 months after the withdrawal of the 2011 Rule Filing, FINRA filed the Proposal Notice.

COMMITTEE COMMENTS

As a general matter, the Committee has grown increasingly concerned with the limited time period under which it must review, analyze and develop comment letters addressing FINRA rules. The Committee believes that the limited time period for assessment and comment on the Proposed Rule Changes creates significant challenges to an effective and productive comment process. While certain rule changes may allow for quick review and analysis, other more sweeping and comprehensive rule changes can create a very challenging environment for a

[3] Regulatory Notice 08-24 (May 2008) ("RN 08-24").
[4] The initial rule filing was published in SEC Release No. 34-64736, 76 Fed. Reg. 38245 (June 29, 2011) ("2011 Rule Filing").
[5] The 2011 Rule Filing was withdrawn by notice from FINRA to the SEC and such withdrawal was published in the Federal Register on October 11, 2011. *Notice of Withdrawal of Proposed Rule Change To Adopt Rules Regarding Supervision in the Consolidated FINRA Rulebook,* 76 Fed. Reg. 62890 (Oct. 11, 2011).

complete, deliberate and thoughtful review within 21 days.[6] The Committee recognizes that the rulemaking process is undertaken pursuant to a required statutory framework, but would appreciate ongoing consideration as to whether there may be a process under which certain more comprehensive FINRA rule changes could receive additional time for review.

The Committee believes that a number of aspects of the Proposed Rule Changes provide welcome changes to the existing requirements. For example, the Committee believes that the determination to reject certain provisions that would have required expressly articulated oversight of the non-securities business of a member firm, and the reliance in certain instances on risk-based review process are helpful and well-reasoned approaches. However, there are a number of aspects of the Proposed Rule Changes upon which the Committee provides more detailed comments below.[7]

FINRA RULE 3110(d) – REVIEW OF TRANSACTIONS OF ASSOCIATED PERSONS

Proposal. FINRA Rule 3110(d) would require a member to include in its supervisory procedures a process for the review of securities transactions that are effected for the accounts of the member and/or the member's associated persons and certain family members (i.e., "covered accounts") to identify trades that may violate the provisions of the Securities Exchange Act of 1934 ("Exchange Act"), the rules thereunder, or FINRA rules prohibiting insider trading and manipulative and deceptive devices. Under FINRA Rule 3110(d)(3)(A), a "covered account" would include, among other things, "any account held by the spouse, domestic partner, child, parent, sibling, son-in-law, daughter-in-law, father-in-law, or mother-in-law of a person associated with a member where such account is introduced or carried by the member." FINRA Rule 3110(d)(1)(B) would also require a firm to conduct promptly an internal investigation into any such trade to determine whether a violation of those laws or rules has occurred.

Pursuant to FINRA Rule 3110(d)(2), any member that engages in "investment banking services" would also be required to provide reports to FINRA regarding the investigations conducted under FINRA Rule 3110(d)(1)(B). FINRA Rule 3110(d)(3)(B) defines the term "investment banking services" to include, without limitation: acting as an underwriter; participating in a selling group in an offering for the issuer, or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.

Comment – Reasonable Review of Transactions. The Proposal Notice provides a significant amount of guidance with respect to the transaction review process under FINRA Rule 3110(d). In the Proposal Notice, FINRA confirms that "[t]here is no implied obligation on firms

[6] The Committee notes that, while the proposed text of any FINRA rule filing is available prior to its publication in the Federal Register, past experience has proven that undertaking an effort to review and develop analysis and comments in advance of publication in the Federal Register may result in wasted time and effort given that rule filings are sometimes withdrawn up until such publication.

[7] The order of comments in this letter does not reflect the relative importance that the Committee attributes to any comment herein.

as to how to best conduct reviews."[8] In addition, FINRA indicates that (1) firms are permitted to take a risk-based approach to monitoring trading activity, and (2) the review should be guided by the firm's business model.[9] FINRA also indicates, in response to comments, that there will be "no obligation on members to establish electronic feeds of trading activity at other firms" under FINRA Rule 3110(d). [10]

The Committee supports the approach identified in the Proposal Notice with respect to the risk-based review of transactions under FINRA Rule 3110(d). The Committee reads the ability to craft a risk-based approach to transaction review as creating the possibility that, for certain firms, and certain associated persons of such firms, there would be no need to periodically review transactions. In addition, the Committee notes that it understands that the obligations imposed under FINRA Rule 3110(d) to review transactions does not, in any manner, modify the obligations imposed under current NASD Conduct Rule 3050 related to transactions of an associated person at another member firm.

Comment – Definition of "Covered Account." As indicated above, FINRA creates a special class of individuals related to an associated person for whom there is an obligation to review transactions. The Committee understands that most insider trading cases involve individuals with a special relationship with the associated person. However, the definition of "covered account" is over-inclusive in its efforts to capture and review the accounts of those persons. For example, the list of individuals who would meet the test of holding a covered account would be over-inclusive because it could include a group of individuals that the associated person has no real relationship with, or even knowledge that they might have an account with the firm.

Further, the Committee notes that the term "domestic partner" is vague and undefined and should have a more explicit definition.

The Committee also notes that collecting the information on the covered accounts, and reviewing those accounts as required under the proposed rule, has the potential to be extremely burdensome. Simply building out a questionnaire for associated persons to discover the identities of the possible owners of covered accounts, or modifying customer account applications to capture the relevant accounts will be extremely burdensome. In addition, capturing the information and then implementing the review of that information using existing surveillance systems will also be burdensome. Unfortunately, it also seems likely the possibility of this information serving as an effective deterrent or surveillance tool would be very limited. Given that an associated person would be likely to know and understand the rule, if they do have a special relationship with an individual within the scope of the "covered account" circle, it seems logical that they would simply direct them to open an account at any other broker-dealer to avoid any possible review of their account. As a result of the potential burdens of the proposed transaction review, and the limited utility of such a required review of the covered accounts maintained by the firm to deter violations, the Committee recommends that FINRA

[8] 78 Fed. Reg. at 40809.
[9] *Id.*
[10] *Id.*

eliminate the express references to the family members that would be deemed to hold covered accounts and rely instead on the Exchange Act's general obligations imposed on firm's with respect to insider trading review.

In the alternative, the Committee recommends that FINRA consider choosing a definition of "covered accounts" that is in harmony with other, related securities rules. In particular, the Committee believes that use of the "beneficial ownership" standard under Exchange Act Rule 16a-2(a)(2) provides a better alternative (i.e., members of a person's immediate family sharing the same household). The Committee believes that standard does not suffer from the "over-inclusive" issues to the same extent as the proposed definition of "covered account" given that it relies on a nexus between the associated person and the family member. Because beneficial ownership is the linchpin of personal securities reporting requirements under the Investment Advisers Act of 1940 (the "Advisers Act"),[11] this standard would create uniformity among terms that can be used across business lines.

Comment – Definition of "Investment Banking Services." As described above, the term "investment banking services" is defined broadly to include: acting as an underwriter; participating in a selling group in an offering for the issuer, or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer. Under FINRA Rule 3110(d), a firm that is engaged in investment banking services is required to submit reports related to any of its investigations of trading activity to FINRA. As indicated by FINRA, the purpose of imposing additional obligations on firms that are engaged in investment banking services is because they "may have special access to material, non-public information, which increases the risk of insider trading."[12]

The Committee notes that this definition received significant and uniform comments under the 2011Rule Filing from the Committee and others suggesting that the proposed definition would capture many more firms than FINRA was actually targeting due to such firm's heightened risk with respect to insider trading. A number of commenters identified that the target of the enhanced reporting obligations would be misapplied if it was applicable to broker-dealers serving as principal underwriters of variable annuities or involved in the sale of variable annuities and other similar products (e.g., mutual funds and 529 plans). FINRA offered up no evidence that firms serving as a principal underwriter or selling firm of variable annuities would have special access to non-public information that would increase the risk of insider trading.

The Committee further notes that FINRA provided very little feedback to the substantive concerns and simply stated, with little or no reasoning, that it does not believe "any of the categories of activity identified by the commenters should be categorically excluded."[13] FINRA appears to base its response to the comments on this issue solely on its view that the burden of the reporting requirements under the proposed rule would not be significant. In that regard,

[11] Rule 204A-1 under the Advisers Act.
[12] 78 Fed. Reg. at 408010.
[13] *Id.*

FINRA states that, to the extent the commenters are correct about the mis-targeted application of the rule, "the instances of reporting obligations on firms that only engage in those activities should not be significant."[14]

The Committee believes that FINRA should adopt rules that protect investors and create a meaningful regulatory structure. Further, the Committee believes that failing to craft a rule that recognizes the impact of that rule on a significant group of firms, simply because FINRA's current view that the burden imposed is slight, shows disregard for, and a misunderstanding of, the cumulative impact a misapplied rule can have on a firms's regulatory compliance obligations. In addition, it underestimates substantially the unnecessary questions and confusion surrounding the rule's implementation that the firm is likely to face. The Committee urges that the reporting obligations under FINRA Rule 3110(d)(2), based on the over-broad definition of "investment banking services," be revised in a manner that more specifically targets the firms that create a heightened risk of insider trading. In that regard, the Committee suggests that the proposed rules (or SMs) specifically exempt variable insurance product principal underwriters and broker-dealers selling such products. A close examination of the role of both the principal underwriter and the selling firm distributing variable annuity contracts would indicate that they should not be subject to the obligations to report findings pursuant to FINRA Rule 3110(d)(2) as they do not create any heightened risk of insider trading.

FINRA RULE 3110(b)(4) – REVIEW OF INTERNAL COMMUNICATIONS

Proposal. Under FINRA Rule 3110(b)(4), firms are required to have supervisory procedures in place to require the member's review of "internal communications to properly identify those communications that are of a subject matter that require review under FINRA and MSRB rules and federal securities laws." SM.07 provides for the use of a risk-based review for internal communication that are "not of a subject matter that require review under FINRA and MSRB rules and federal securities laws. . . ." The Proposal Notice provides a list of certain internal communications that FINRA believes provide an example of those internal communications that must be reviewed under applicable requirements including the following:

- Communications between non-research and research departments concerning a research report's contents (NASD Rule 2711(b)(3) and Incorporated NYSE Rule 472(b)(3));
- Certain communications with the public that require a principal's pre-approval (FINRA Rule 2210);
- The identification and reporting to FINRA of customer complaints (FINRA Rule 4530); and
- The identification and prior written approval of changes in account name(s) (including related accounts) or designation(s) (including error accounts) regarding customer orders (FINRA Rule 4515).

[14] *Id.*

Comment. The Committee believes that the requirement that would be placed upon members to have supervisory procedures that properly *identify* communications that require review is vague and unnecessary. We think that this section would be more effective if it is targeted to a firm's obligation to review internal communications and not seek to impose any specific obligations with respect to how firms identify communications requiring review. If FINRA determines to maintain this requirement we would request that FINRA provide guidance as to appropriate methodology for identifying such communications.

FINRA RULE 3110(C) – OFFICE INSPECTIONS

Proposal. FINRA Rule 3110(c) sets forth a series of requirements with respect to office inspections focusing on who may conduct the inspections, when they must be conducted, and how they are documented. FINRA Rule 3110(c)(3) requires that a member must prevent inspection standards from being reduced in any manner due to any conflicts of interest that may be present, including but not limited to, conflicts between the associated persons conducting the inspections and businesses being inspected. The firm must ensure that the person conducting the inspection is not an associated person (1) assigned to the location, or (2) directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to the location (unless compliance with this provision is not possible either because of a member's size or its business model).

Comment. The Committee requests that the provision compelling firms to reduce conflicts related to inspections be modified in order to provide firms with more flexibility to design their own policies and procedures that serve to safeguard their inspections from conflicts of interest. Some firms have located personnel in offices who routinely conduct inspections and carry out supervisory responsibilities in the office. This provision could have the unintended effect of forcing firms to remove such valuable onsite personnel from the local offices. The Committee believes strongly that taking a more principles-based approach to the permitted identity of the personnel carrying out the office inspections would be beneficial to firms and investors. The Committee recommends that where an otherwise "conflicted" person conducts an office inspection, FINRA rules should allow for other considerations to overcome the conflict. For example, firm's using conflicted individuals to conduct the inspection could be required to have the inspection reviewed and approved by a registered principal of the firm without a conflict. This type of approach would have the benefit of allowing individuals with intimate knowledge of the office to conduct the inspection, but then utilize another individual to review the report and sort through any indication that a conflict impaired the review process.

In addition, the Committee further believes that the current prohibition may lead to particularly illogical and unwieldy results with respect to the inspection of home offices or administrative offices of a member firm. In many cases, the home office inspection team is likely to be located at the home office of the member firm. The Committee believes that FINRA should amend SM.15 to include associated persons located in a home office, or an administrative office, and conducting inspections of such offices, as an additional example of generally allowed exceptions from the office inspection personnel restrictions.

OSJ SUPERVISION RULES

Proposal. There are several SMs that address the general topic of supervision of supervisors. SM .03 is titled "One-Person OSJs" and would require that a "senior principal" regularly supervise the activities of an "on-site principal" who operates a one-person OSJ. According to SM.03, the senior principal must conduct "on-site supervision of such OSJ location on a regular periodic schedule."

SM .04 would establish a general presumption that a principal will not be assigned to supervise more than one OSJ. SM .04., titled "Supervision of Multiple OSJs by a Single Principal" also sets forth factors a member should consider if assigning a principal to two or more OSJs.

Comments. The Committee believes that the proposals setting forth the parameters for OSJ supervision in SM.03 and SM.04 are too rigid and unworkable and they fail to acknowledge that firms regularly conduct business through diverse business structures. The Committee notes in particular that the obligations, including those pertaining to on-site supervision by the senior principal, will be extremely costly and unnecessarily burdensome for certain firms. The Committee recommends that, rather than require senior principal on-site presence, firms should be permitted to create a supervisory structure that demonstrates "eyes and ears" supervision over the on-site principal in whatever manner may be appropriate (e.g., document weekly update calls, enhanced email review). The Committee strongly recommends that each of SM.03 and SM.04 be revised to provide a less rigid framework under which the supervision of offices is constructed based on a firm's risk-based assessment of the appropriate manner to supervise the OSJs.

* * * * *

The Committee appreciates this opportunity to comment on the Proposed Rule Changes. Please do not hesitate to contact Cliff Kirsch ([redacted] or Eric Arnold [redacted]) if you have any questions.

Respectfully submitted,

Clifford Kirsch

Eric A. Arnold

APPENDIX A

COMMITTEE MEMBERS

AIG Life & Retirement
Allianz Life
Allstate Financial
AVIVA USA Corporation
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
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
Symetra Financial
The Transamerica companies
TIAA-CREF
USAA Life Insurance Company