SUTHERLAND

SUTHERLAND ASBILL & BRENNAN LLP
1275 Pennsylvania Avenue, NW
Washington, DC 20004-2415
202.383.0100 Fax 202.637.3593
www.sutherland.com

August 26, 2011

VIA ELECTRONIC MAIL

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

Re: File No. S7-23-11; Release No. 34-64676
Broker-Dealer Reports

Dear Ms. Murphy:

This letter is submitted on behalf of our client, the Committee of Annuity Insurers (the "Committee"),[1] in response to *Broker-Dealer Reports* (the "Proposing Release").[2] The Proposing Release requests comment on three sets of amendments to Rule 17a-5 under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

The first set of amendments (collectively, the "Annual Reporting Amendments") would (i) update existing Rule 17a-5 requirements, (ii) facilitate the ability of the Public Company Accounting Oversight Board (the "PCAOB") to implement oversight of independent public accountants of broker-dealers as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), and (iii) eliminate potentially redundant requirements for

---

[1] The Committee of Annuity Insurers is a coalition of 32 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 over 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

[2] The Proposing Release was published as Release No. 34-64676 (Jun. 15, 2011) ("Proposing Release").

certain broker-dealers affiliated with, or dually-registered as, investment advisers. The second set of amendments (collectively, the "Access to Audit Documentation Amendments") would require broker-dealers that either clear transactions or carry customer accounts to consent to provide the Securities and Exchange Commission (the "Commission" or the "SEC") and the broker-dealers' designated examining authorities ("DEAs") with access to their independent public accountants for the purpose of discussing the broker-dealer's annual audit and reviewing related audit documents. The third set of amendments would require broker-dealers to file a new Form Custody. All three sets of the proposed amendments to Rule 17a-5 are collectively referred to herein as the "Proposal."

The Committee appreciates the Commission's efforts to implement required elements of the Dodd-Frank Act and supports efforts to streamline and modernize existing SEC regulations. The Committee, however, has serious concerns regarding the scope and applicability of some of the requirements of the Proposal. Some aspects of the Proposal provide welcome updates to existing reporting requirements but others are overly broad or require clarification. The Committee also believes that the proposed implementation date is too aggressive. Broker-dealers would not have adequate time to prepare for the audits and could be forced to re-do audit plans that are already in process.

The Committee's specific comments are provided below.

I. PROPOSED ANNUAL REPORTING AMENDMENTS

Proposal. Currently, Rule 17a-5 requires broker-dealers to file an annual report (an "Annual Audit Report") containing audited financial statements, supporting schedules and supplemental reports, as applicable, with the Commission and any other DEA of the broker-dealer (*e.g.*, FINRA). Under the Proposal, the requirement that broker-dealers file an Annual Audit Report would remain unchanged. "Carrying broker-dealers," however, would be required to file annually a new report asserting compliance with specified rules and internal controls (the "Compliance Report").

In addition, the Proposal would require each carrying broker-dealer to engage an independent public accountant to examine the broker-dealer's assertions in the Compliance Report (a "Compliance Examination") and issue an Examination Report, and the broker-dealer would be required to file the Examination Report with the Commission. Under proposed paragraph (d)(2) of Rule 17a-5, broker-dealers who are "exempt from the provisions of § 240.15c3-3" (*i.e.*, who "do not hold customer funds or securities" under the Proposing Release) would be required to file with the Commission (i) a report asserting their exemption from the

requirements of Rule 15c3-3 (the "Exemption Report") and (ii) a report from their independent public accountant that would be the result of the accountant's review of the broker-dealer's assertion that it is exempt from Rule 15c3-3. The Commission is proposing to make the Annual Reporting Amendments effective for annual reports filed with the Commission for fiscal years ending on or after December 15, 2011.

The Annual Reporting Amendments also propose to change the form of reports currently provided by broker-dealers to the Securities Investment Protection Corporation ("SIPC"). Currently broker-dealers claiming an exemption from membership in SIPC must file with the Commission, SIPC and their DEA a supplemental report (the "Supplemental Report"), which report includes a statement that the broker-dealer is qualified for an exclusion from SIPC membership; this statement must be covered by an opinion of the broker-dealer's independent public accountant. The Proposal would require broker-dealers to continue to file Supplemental Reports with the Commission, the broker-dealer's DEA and SIPC until such time as SIPC, by rule, prescribes a new form of Supplemental Report and the SEC approves that form.

Committee Comments.

A. The Definition of "Carrying Broker-Dealer" Requires Clarification.

Under the Proposal, the definition of "carrying broker-dealer" varies; the term is defined differently in different places in the Proposal and in the proposed Form Custody. Since the meaning ascribed to the term will be of paramount importance in applying any new rules, the Committee believes that the Commission should make the definition clear in any release adopting amendments to Rule 17a-5.

In the Proposing Release, the Commission first defines a carrying broker-dealer as one that "maintain[s] custody of customer funds or securities."[3] For purposes of proposed new Form Custody, the Commission defines a carrying broker-dealer as one who "hold[s] cash and securities"[4] and also as one that "holds customer accounts."[5] The instructions for Item 3.A of proposed new Form Custody define a carrying broker-dealer as a broker-dealer "that introduces customer accounts to another broker-dealer on an omnibus basis ... with respect to those

---

[3] Proposing Release, Section II(A).

[4] Proposing Release, Section IV(A).

[5] Proposed Form Custody, General Instructions, A.5.

accounts under the Commission's broker-dealer financial responsibility rules."[6] In its analysis of the Proposal under the Paperwork Reduction Act of 1995, the Commission refers to carrying broker-dealers as broker-dealers that "maintain custody of customer funds and/or securities and are required to comply with the customer protection provisions of Rule 15c3-3."[7]

Paragraph (a)(2)(i) of Rule 15c3-1 of the Exchange Act (the "Net Capital Rule") specifies that a broker-dealer is deemed to carry customer or broker-dealer accounts "if, in connection with its activities as a broker or dealer, it receives checks, drafts, or other evidences of indebtedness made payable to itself or persons other than the requisite registered broker or dealer carrying the account of a customer, escrow agent, issuer, underwriter, sponsor, or other distributor of securities." Paragraph (a)(2)(i) of Rule 15c3-1 further provides that a broker or dealer shall be deemed to hold securities for, or to carry customer or broker or dealer accounts, and hold securities of, those persons if it does not promptly forward or promptly deliver all of the securities of customers or of other brokers or dealers. Rule 15c3-1(c)(10) provides that a broker-dealer is deemed to "promptly forward" funds or securities "only when such forwarding occurs no later than noon of the next business day following receipt of such funds or securities."

The Committee believes that the existing definitions found in Rule 15c3-1 clearly articulate the legal standard of what it means to be a "carrying broker-dealer" for purposes of the Commission's financial responsibility rules. In light of these definitions and the securities industry's reliance on these definitions over the years, the Committee requests that the Commission clarify in any release adopting amendments to Rule 17a-5 that the use of the term "carrying broker-dealer" in Rule 17a-5 and Form Custody should be defined by reference to the definitions provided in paragraph (a)(2)(i) of SEC Rule 15c3-1.

B. The Term "Carrying Broker-Dealer" Should Not Apply to "Limited Purpose Broker-Dealers."

In the Proposing Release, the Commission asks whether there are types of broker-dealers that would not qualify to file an Exemption Report, but, based on the limited scope of their businesses, should be allowed to file a more limited report than the Compliance Report.[8] The Committee believes the answer to this question is "yes," because all broker-dealers do not fit

---

[6] Proposed Form Custody, Instructions for Specific Line Items, Item 3.A.

[7] Proposing Release, Section VI(C).

[8] Proposing Release, Section II(B)(5).

neatly within the two categories of broker-dealers the Proposal would establish, *i.e.*, carrying broker-dealers and broker-dealers relying on an exemption from Rule 15c3-3.

When Rule 15c3-3 was first adopted, the exemptions contained in paragraph (k) of the rule made sense for the business models prevalent at that time. As you know, there are two principal paragraph (k) exemptions. Paragraph (k)(1) exempts from Rule 15c3-3 a broker or dealer whose business is limited to acting as an agent or dealer for shares of registered investment companies or of interests or participations in an insurance company separate account. In addition to distributing only a limited number of products, a broker-dealer relying on the paragraph (k)(1) exemption must promptly transmit all funds and deliver all securities and is prohibited from otherwise holding funds or securities for, or owing money or securities to, its customers. "Promptly transmit" for these purposes is interpreted as transmittal by noon of the business day next following receipt.[9]

Paragraph (k)(2) exempts from Rule 15c3-3 a broker or dealer, regardless of the types of securities offered for sale, who carries no margin accounts, promptly transmits all customer funds and delivers all securities, does not otherwise hold funds or securities for, or owe money or securities to, customers and who effectuates all financial transactions between the broker or dealer and its customers through one or more special bank accounts.[10] Paragraph (k)(2) also exempts a broker or dealer who acts only as an introducing broker or dealer and clears all transactions with and for customers on a fully disclosed basis with a clearing broker-dealer. Broker-dealers relying on paragraph (k)(2) must also promptly transmit all customer funds and securities to the clearing broker-dealer that carries the customer accounts, and the clearing broker-dealer must maintain books and records for the accounts pursuant to SEC Rules 17a-3 and 17a-4.[11] As is the case with the paragraph (k)(1) exemption, the term "promptly transmit" as used in paragraph (k)(2) is interpreted to require transmittal by noon of the business day next following receipt of the customer's funds or securities.

Over the years, the ability of a broker-dealer to rely on any of the paragraph (k) exemptions has grown increasingly difficult. If a broker-dealer, even one whose distribution is

---

[9] In 2007, the Commission issued an exemptive order that makes it possible for broker-dealers relying on paragraph (k)(1) to hold checks made payable to the issuer of a variable annuity contract past noon of the next following business day. *See* Release No. 34-56376 (Sept. 7, 2007).

[10] Such bank accounts must be established in compliance with SEC Rule 15c3-3(e).

[11] Paragraph (k) of Rule 15c3-3 also authorizes the Commission to exempt a broker or dealer from Rule 15c3-3 upon written application by the broker or dealer. *See* Rule 15c3-3(k)(3).

primarily limited to variable insurance products and mutual funds (hereafter, a "limited purpose broker-dealer") has a sales force "in the field," that broker-dealer will have great difficulty complying with the requirement that all customer funds and securities be transmitted to a third party by noon of the next following business day. For example, a registered representative working in a field office for a broker-dealer distributing mutual funds will receive checks made payable to the mutual fund sponsor on "Day 1." Typically, the registered representative must forward these checks to its home office – which typically will be in a different state from the branch office - so that a principal-level suitability review can be performed and the broker-dealer's anti-money laundering ("AML") procedures can be applied, among other things. The functions performed by the home office are required by FINRA rules, i.e., performing these functions is mandatory. There may also be account opening issues associated with the receipt of the check, *e.g.*, the check may be from a new customer, in which case additional reviews will need to be conducted by the home office and by the broker-dealer's clearing firm. These reviews cannot be done by "Day 2," illustrating one of the key problems with the paragraph (k) exemptions when applied to today's business models: in most cases it is simply not possible for broker-dealers doing a limited business to comply with the delivery timeframe established by the paragraph (k) exemptions.

In the Committee's experience, the difficulties faced by limited purpose broker-dealers trying to rely on a paragraph (k) exemption have, in some cases, led such broker-dealers to apply to FINRA for "carrying broker-dealer" status. Under the Proposal, these broker-dealers would be treated in the same manner as broker-dealers that have much different business models, receiving checks made payable to the broker-dealer as a matter of course. The Committee believes that limited purpose broker-dealers should not be grouped together with broker-dealers that truly follow a "full purpose" business model; limited purpose broker-dealers should not be required to submit a Compliance Report to the Commission because the purposes of the Compliance Report do not reflect the limited purpose broker-dealer business model.

Limited purpose broker-dealers instruct their customers to make checks for the purchase of securities payable to a third party, not to the broker-dealer, and transmit such checks as quickly as possible, given the requirements of mandatory suitability, AML and other rules, to the third party to whom the check is made payable. Thus, such broker-dealers do not meet the definition of a "carrying broker or dealer" under SEC Rule 15c3-1(a)(2)(i). Limited purpose broker-dealers do not seek to handle customer funds or securities as part of their business models and accordingly they do not pose the same risk to the financial security of customer accounts as those carrying broker-dealers raising the policy concerns supporting the Proposal.

C. Broker-Dealers Relying on Paragraph (k)(2)(1) Should Not Be Deemed "Carrying Broker-Dealers" under Rule 17a-5 or Form Custody.

As you know, FINRA adopted new financial responsibility rules as part of the consolidation of NASD and New York Stock Exchange Rules.[12] These rules generally provide that for purposes of the FINRA financial responsibility rules, all requirements that apply to a FINRA member firm that clears or carries customer accounts shall also apply to any FINRA member that relies on the paragraph (k)(2)(i) exemption from Rule 15c3-3, and either clears customer transactions pursuant to such exemptive provisions or holds customer funds in a bank account established pursuant to Rule 15c3-3(k)(2)(i). The Committee requests that the Commission make clear that FINRA rules are not meant to conflict with the requirements of the Proposal, *i.e.*, a broker-dealer relying on any of the exemptive provisions of Rule 15c3-3(k) is entitled to file an Exemption Report.

D. The Compliance Reporting Requirements as Proposed Are Over-Inclusive and Burdensome.

Under the Proposal, a broker-dealer would be required to file under Rule 17a-5(d) two reports with the Commission – either a Financial Report and a Compliance Report or a Financial Report and an Exemption Report. With respect to the Compliance Report, under proposed paragraph (d)(3)(ii) of Rule 17a-5, a broker-dealer could not assert compliance with Rule 15c3-1, Rule 15c3-3, Rule 17a-13, Rule 17a-5, and rules prescribed by DEAs requiring broker-dealers to send account statements to customers (collectively, the "Financial Responsibility Rules"), as of its most recent fiscal year-end, if it identifies one or more instances of material non-compliance. Instead, the broker-dealer would need to identify and describe any instance of material non-compliance, as of its most recent fiscal year-end, in its Compliance Report.

The Compliance Report would require carrying broker-dealers to make two key determinations regarding their compliance with the Financial Responsibility Rules. First, a carrying broker-dealer would need to determine whether it has experienced any instance of material non-compliance with respect to the Financial Responsibility Rules. The Commission proposes to define an instance of material non-compliance under Rule 17a-5(d)(3)(ii) as a failure by the broker-dealer to comply with any of the requirements of the Financial Responsibility Rules in all material respects. Under the Proposal, any failure by the broker-dealer to perform any of the procedures enumerated in the Financial Responsibility Rules would be an instance of

[12] *See, e.g.*, FINRA Rule 4110 et al.

non-compliance; therefore, the broker-dealer would have to evaluate any such failure to determine whether it is material and thus required to be reported in the broker-dealer's Compliance Report.[13]

When determining whether an instance of non-compliance is material, the Commission states that it preliminarily believes that a broker-dealer should consider all relevant factors including (i) the nature of the compliance requirements, (ii) the nature and frequency of non-compliance identified, and (iii) qualitative considerations. The Proposing Release states that the Commission believes that some deficiencies would necessarily constitute instances of material non-compliance, including failing to maintain the required minimum amount of net capital under Rule 15c3-1 or failing to maintain the minimum deposit requirement in a special reserve bank account under Rule 15c3-3.[14]

Second, under proposed paragraph (d)(3)(iii) of Rule 17a-5, a broker-dealer could not assert in its Compliance Report that its internal control over compliance with the Financial Responsibility Rules during the fiscal year was effective if one or more material weaknesses exist with respect to internal control over compliance. The term "material weakness" would be defined under proposed paragraph (d)(3)(iii) of Rule 17a-5 to mean a deficiency, or combination of deficiencies, in internal control over compliance with the Financial Responsibility Rules, such that there is a reasonable possibility that material non-compliance with those provisions will not be prevented or detected on a timely basis. If one or more material weaknesses exist, under proposed paragraph (d)(3)(i)(C), the broker-dealer would need to describe in the Compliance Report each material weakness identified during the fiscal year. Under the Proposal, an instance of non-compliance that the broker-dealer has determined does not constitute material non-compliance may nonetheless be indicative of a control deficiency that constitutes a material weakness.[15]

The Committee believes that the reporting thresholds created by the material non-compliance and material weakness standards are too high. In essence, these standards seem designed to require broker-dealers to conclude that they have achieved 100 percent compliance with the Financial Responsibility Rules – if they cannot make that determination, the rules seem to require self-reporting through the vehicles of the Compliance Report or the Exemption Report. Given the complexity of the Rules, broker-dealers should be permitted to make reasonable

---

[13] Proposing Release, Section II(B)(1).

[14] *Id.*

[15] *Id.*

judgments regarding the severity of an event of non-compliance – in other words, no event should be pre-judged to, in the Commission's words, "necessarily constitute instances of material non-compliance."[16] Each event should be evaluated pursuant to its own facts and circumstances.

If the definitions of material non-compliance and material weakness stand as proposed, they will be unduly burdensome for broker-dealers to administer and are likely to result in over-reporting to the SEC. Broker-dealers may feel that they have no choice but to report every possible potential non-compliance event in their Compliance Report rather than risk second-guessing by their auditors or the staff. The over-inclusion of potential instances of non-compliance would result in a flood of reporting that would leave the Compliance Report an ineffective tool for auditors, the Commission, and customers to evaluate a broker-dealer's strength of compliance with the Financial Responsibility Rules.

The Compliance Report should be a report that is focused on those issues most vital to the financial condition of the broker-dealer and its compliance and internal control over compliance. In order to achieve this focus, the Commission should articulate a "facts and circumstances" approach.

The issues created by the proposed material non-compliance and material weakness standards and the Commission's proposed interpretation of those standards flow through to other aspects of Rule 17a-5. Specifically, a broker-dealer's obligation to make its Statements of Financial Condition available to its customers would be negatively impacted. Under the Proposal, paragraph (c)(5)(vi) of Rule 17a-5 would provide that a broker-dealer may make Statements of Financial Condition available online, in lieu of sending statements to customers in paper form, "provided its financial statements receive an unqualified opinion from the independent public accountant and neither the broker-dealer nor the independent public accountant identifies material weakness or an instance of material non-compliance."[17] Under the Proposal, a broker-dealer could not attest internal control over compliance with the Financial Responsibility Rules if one or more material weaknesses exist with respect to internal control over compliance. Thus, if a broker-dealer does not assert a 100 percent rate of compliance with the Financial Responsibility Rules, then the broker-dealer would have to incur the costly additional expense of mailing its statements of financial condition to customers. Moreover, customers would have to weed through lengthy paper reports that ultimately would not be the most user-friendly means of communicating those compliance instances most relevant to the

---

[16] *Id.*

[17] *Id.*

customer's concerns regarding the financial stability of the broker-dealer and the safekeeping of the customer's assets.

We also note that customers will likely receive in the future paper mailings of their customer account statements on a monthly basis, rather than quarterly, because of a proposed change to FINRA's customer account statement rule. As part of its efforts to develop a consolidated rulebook, FINRA has proposed to adopt its customer account statement rule (currently NASD Rule 2340) as new Rule 2231 in the FINRA Consolidated Rulebook.[18] New Rule 2231 would require broker-dealers doing a general securities business to mail account statements to customers on a monthly basis unless an exemption is available under the FINRA rule.[19] The costs associated with monthly rather than quarterly mailings are extremely high; current estimates are in the millions of dollars for each broker-dealer.[20]

The Committee believes that the Commission should coordinate its approach to the delivery of broker-dealer financial information with FINRA, so that realistic assumptions regarding delivery costs for both financial statements and customer account statements can be determined. The combined aggregate costs that will be imposed on broker-dealers because of the proposed FINRA monthly mailing requirement, and mailings required because of the proposed amendments to Rule 17a-5, should be taken into consideration when determining what delivery mechanism makes the most sense. Alternatives to the US mail should be considered given the associated expense. Accordingly, the Committee urges the Commission to determine the costs associated with the combined mailings proposed to be required under SEC and FINRA rules and then propose alternatives to delivery by mail. By way of example, the Committee believes that an approach similar to the "notice and access" process for proxy materials set forth in Rule 14a-16 under Regulation 14A of the Exchange Act would provide the same level of notice to customers as the delivery of complete financial statements, while significantly lessening the regulatory burden and mitigating some of the costs borne by broker-dealers.

---

[18] *See* FINRA File No. SR-FINRA-2009-028, SEC Release No. 34-64969, 76 FR 46340 (August 2, 2011) (hereafter cited as "FINRA Customer Account Statement Proposal").

[19] FINRA Rule 2331 would permit a broker-dealer to deliver an account statement electronically if it receives affirmative consent to that delivery method from the customer.

[20] *See* FINRA Customer Account Statement Proposal at 76 FR 46342 and n. 27.

E. The Proposed Notification Requirements Should Be Amended to Require Auditor Notification to the Audit Client Prior to Notification to the Commission.

Paragraph (g) of proposed amended Rule 17a-5 will require independent public accountants to notify the Commission within one business day of determining that any material non-compliance exists and has been discovered by the accounting firm during the course of preparing its reports. The Proposing Release explains that this new requirement will take the place of an existing requirement - currently found in paragraph (h)(2) of Rule 17a-5 - pursuant to which accounting firms notify the audit client of the accountant's finding of material inadequacy and then the audit client notifies the Commission, or, if the audit client does not provide notice to the Commission promptly, the accounting firm notifies the Commission.

The Committee requests that the proposed rule be amended to require a broker-dealer's accounting firm to provide notice to the broker-dealer prior to providing notice to the Commission. Broker-dealers should be provided prior notice so that they are prepared to respond to Commission staff questions, can work effectively with their accounting firms to address the issue(s), and, if appropriate, can comply with other reporting obligations, such as those found in SEC Rule 17a-11 and the FINRA financial responsibility rules.

The Committee also requests that as amended, Rule 17a-5 give confidential treatment to an independent public accountant's notice to the Commission of a finding of material non-compliance. We believe that confidential treatment currently attaches to an auditor's notice to the SEC of a finding of material inadequacy; the new notices that will take the place of material inadequacy filings should also be treated as confidential.

F. Use of the Examination Report to Satisfy the IA Custody Rule's Internal Control Report Requirement Is Appropriate.

The Commission has proposed that the Examination Report, which will be written by each carrying broker-dealer's public accountant, could be used to satisfy the internal control report requirement under the Investment Advisers Act of 1940. In other words, a carrying broker-dealer that is dually registered as an investment adviser and acts as a qualified custodian for itself, and carrying broker-dealers that act as qualified custodians for related investment advisers, would be able to use the Examination Report to satisfy the requirements of both Rule 17a-5 and Rule 206(4)-2 under the Advisers Act. The use of the Examination Report for the

purpose of complying with Rule 206(4)-2 would not be available for non-carrying broker-dealers that act as qualified custodians under the Advisers Act.[21]

The Committee supports this dual use of the Examination Report and urges the Commission to adopt this aspect of the proposed amendments to Rule 17a-5 as proposed.

G. The Material Modification Standard Proposed in Connection with the Exemption Report Is Unreasonable.

Under the Proposal, a non-carrying broker-dealer claiming an exemption from Rule 15c3-3 would be required to file (i) an Exemption Report asserting that it is exempt from the provisions of Rule 15c3-3 because it meets one or more of the conditions with respect to its business activities under Rule 15c3-3(k) and (ii) a corresponding report prepared by its independent public accountant in lieu of filing the Compliance Report and Examination Report. Under proposed paragraph (g)(2)(ii) of Rule 17a-5, the independent public accountant would review the broker-dealer's assertions in its Exemption Report and prepare a report based on that review and in accordance with standards adopted by the PCAOB. If the independent public accountant is aware of any material modifications that should be made to the assertions contained in the Exemption Report, the accountant must disclose them in its report. Under the Proposal, the Commission states that it preliminarily believes that a broker-dealer's failure to promptly forward any customer securities it received is an example of a discovery that would necessitate a material modification. The Proposal does not otherwise define "material modification."

The Committee believes that to consider a single instance of a broker-dealer failing to promptly forward a customer's securities as an instance that would necessitate a material modification creates an unworkable standard. A single instance of a failure to promptly forward a customer check or securities may be material but it may also not be material, *e.g.,* the check or securities could have been forwarded one day late and it could have been the only instance of non-compliance with the promptly transmit standard during the audit review period.

We use this example to point out that not every instance of non-compliance with the Financial Responsibility Rules is a signal of some larger problem. Every instance of non-compliance needs to be investigated by the member firm, but not every instance of non-compliance should result in a modification statement by a broker-dealer's public accountant. As

---

[21] Proposing Release, Section II(B)(4).

discussed above with respect to the Compliance Report, any standard that creates a 100 percent compliance threshold will lead to over-reporting and the mis-directed use of the broker-dealer's resources. Instead, the Commission should adopt a standard that permits broker-dealers to apply a "facts and circumstances" analysis to the potential non-compliant event.

H. The Liability Attaching to Signatories of the New Reports under Amended Rule 17a-5 Requires Clarification.

The Committee believes that Rule 17a-5 as amended should clearly establish (i) *who* should sign the Compliance and Exemption Reports, and (ii) what liability attaches to the signatories in the event of a misstatement or omission. Given the breadth of the Compliance and Exemption Reports (*e.g.*, the Commission's purposed requirement that a broker-dealer's assertions related to the effectiveness of internal control over compliance would not pertain to a fixed point in time but instead would cover the entire fiscal year), it should be clear that the legal standard applicable to the attestations contained in the reports is a "reasonableness standard," *i.e.*, that the signatories may sign the forms if they have a reasonable belief that the representations made in the forms are accurate and complete under the circumstances. In this regard we note that the Proposing Release states that Compliance Report would include a statement as to whether the broker-dealer has established and maintained a system of internal control to provide the broker-dealer with reasonable assurance that any instances of material non-compliance with Rule 15c3-1, Rule 15c3-3, Rule 17a-13, or any applicable self-regulatory organization account statement rule will be presented or detected on a timely basis.[22] The Proposing Release notes in a footnote that the Exchange Act defines "reasonable assurance" and "reasonable detail" in a manner that is different from the concept of "reasonable assurance" in the audit context.[23] The Commission should clarify and incorporate in any release adopting amendments to Rule 17a-5 an exact standard of liability that attaches to the attestations required by the new reports proposed to be incorporated into Rule 17a-5. If the Commission intends that the Exchange Act definitions of "reasonable assurance" and "reasonable detail" govern the liability standard attaching to the new reports, then the Commission needs to make its intentions clear in any release adopting amendments to Rule 17a-5.

Furthermore, the Committee believes that the Commission should make clear that it does not intend for the new Compliance and Exemption Reports to give rise to a new private right of

---

[22] Proposing Release, Section II(B).

[23] Proposing Release at note 43.

action, *i.e.*, only the regulatory authorities to whom the reports are delivered would be able to bring an action based on the reports.

I. Timing of Proposed Implementation.

The Commission's proposed rule amendments include an effective date for annual reports filed with the Commission for fiscal years ending on or after December 15, 2011, with a provision for a transition period for annual reports of carrying broker-dealers filed on or after December 15, 2011, but before September 15, 2012.

The Committee believes that the proposed effective date is too aggressive. The proposed effective date is less than fours months after the end of the comment period and does not provide adequate time for broker-dealers to document their plans for achieving the new objectives, conduct the appropriate training, and ultimately prepare the additional reports and documentation required to support the broker-dealer's assertions. Additionally, for many December 31, 2011 broker-dealer audit engagements, planning and interim procedures have already begun. Audit methodologies and engagement plans have already been designed and would need to be revised, and certain audit procedures may need to be re-performed to ensure the audit meets PCAOB auditing standards. Such changes may require engagement and audit plans – and related fees – to be re-considered and re-approved by broker-dealer Audit Committees and other governing bodies. The Committee requests that the Commission change its proposal with respect to the effective date so that any rule amendments apply only to annual reports filed on or after December 15, 2012.

The Committee believes a delay in the effective date is also warranted in view of the fact that the PCAOB has not adopted the auditing and attestation standards that are proposed to replace generally accepted auditing standards ("GAAS").[24] The Commission is proposing to

---

[24] On June 21, 2011, the PCAOB released a concept release requesting comments on alternatives for changing the auditor reporting model. Comments are due at the PCAOB on September 30, 2011. The PCAOB also announced that it will hold a roundtable to discuss relevant issues sometime in the third quarter of 2011.

The PCAOB issued for public comment two new attestation standards for audits of broker-dealers: *Examination Engagements Regarding Compliance Reports of Brokers and Dealers* and *Review Engagements Regarding Exemption Reports of Brokers and Dealers*. *See* PCAOB Release No. 2011-004 (July 12, 2011), available at http://pcaobus.org/Rules/Rulemaking/Docket035/PCAOB_Release_2011-004.pdf. The PCAOB is also proposing auditing standard *Auditing Supplemental Information Accompanying Audited Financial Statements*, which would supersede the PCAOB's standard, AU sec. 551, *Reporting Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*. *See* PCAOB Release No. 2011-005 (July 12, 2011), available at http://pcaobus.org/News/Releases/Pages/07122011_OpenBoardMeeting.aspx.

require that the audit of the Financial Report, the examination of the Compliance Report, and the review of the Exemption Report be performed pursuant to standards established by the PCAOB. In speaking with public accounting firms, it is our sense that the larger accounting firms have already begun to plan for broker-dealer audits for the fiscal year ending on or after December 31, 2011. In making these preparations the accounting firms are using GAAS standards. It does not seem realistic to change auditing standards without substantial advance notice to the stakeholders most affected by those changes. Broker-dealers are not in a position to estimate and budget for system changes and other costs associated with filing the proposed new reports without knowing the impact of PCAOB auditing standards on the costs of auditor engagements.

J. The Economic Analysis under the Proposal Is Inconclusive Since PCAOB Auditing and Attestation Standards Have Not Been Established.

The Committee believes that the economic analysis of the Proposal is inconclusive since the proposed new reporting requirements are dependent upon PCAOB auditing and attestation standards that have not been finalized. To comply with the Proposal, broker-dealers will need to implement significant operational changes and undertake considerable additional costs in order to enable independent auditor review of the new annual reports. The Committee questions how anyone can estimate the costs associated with preparing and evaluating the new reports under the Proposal when the auditors themselves do not know what auditing standards will apply. We also note that broker-dealer budgets for large compliance changes such as the ones anticipated under the Proposal have to be set well in advance, typically at least one year in advance.

In light of these practical difficulties in accessing the costs of compliance with the Proposal, the Committee believes that the economic analysis of the Proposal, as it currently stands, is inconclusive. Any implementation of the Proposal must be postponed until after the PCAOB establishes its auditing and attestation standards and broker-dealers have had ample opportunity to plan and budget for the new standards.

K. The Filing of SIPC Supplemental Reports with SIPC Increases Regulatory Efficiency and Reduces Regulatory Burdens.

The Committee supports the proposed amendment to the filing of SIPC Supplemental Reports because such an amendment would lessen a filing requirement burden for many broker-dealers, including those affiliated with Committee members.

II. MANDATORY ACCESS TO BROKER-DEALER AUDITORS AND AUDIT DOCUMENTATION

Proposal. Under the Proposal, a clearing or carrying broker-dealer would be required to consent to permitting its independent public accountant (i) to make available to the Commission and the broker-dealer's DEA the independent public accountant's audit documentation associated with its Annual Audit Reports and (ii) to discuss findings relating to the audit reports with Commission and DEA staff. The Commission's requests for such documentation would be made in connection with conducting a regulatory examination of the clearing broker-dealer.

Committee Comments.

A. Requiring Broker-Dealers to Give Mandatory Access to Auditors and Audit Documentation Will Chill the Broker-Dealer Auditing Process.

The Committee believes that requiring broker-dealers to consent to Commission and DEA access to a broker-dealer's independent public accountant and its independent public accountant's work papers would result in a chilling effect on broker-dealer audits. Under the Proposal, broker-dealers would be required to give this consent in advance of knowing whether there are likely to be any issues associated with the audit, and in advance of knowing who the audit team members will be, whether the audit team members know the member firm well (or not at all), and whether they are experienced (or not). Addressing each of these "unknowns" will be made more difficult if, in the course of the audit, the broker-dealer knows that regardless of the nature of an auditing issue and how it was discovered, etc., it cannot freely seek advice from, or discuss the issue openly with, the auditor, without fear of the auditor misunderstanding the broker-dealer's response or simply drawing a conclusion that a broker-dealer's questions indicate the broker-dealer's lack of knowledge or admission of an issue.

The Committee is opposed to this proposed amendment to Rule 17a-5. The Commission has ample other means by which to discuss with the broker-dealer any issues that arise during a broker-dealer examination. Under a proposed amendment to Rule 17a-5, auditors will be required to give notice to the SEC within one business day of determining that any instance of material non-compliance with the Financial Responsibility Rules exists. Once this notice is provided to the Commission, Commission staff will have ample opportunity to discuss any issue of concern with the broker-dealer and the auditor. The Commission would have the opportunity

to "establish the scope and focus of a pending examination"[25] and simply should not need advance consent of the type proposed by paragraph (g) of Rule 17a-5.

B. Requiring Mandatory Consent to Access to Auditors and Audit Documentation will also Chill Attorney Client Communications.

The Committee also believes that the proposed mandatory blanket consent to access to auditors and auditor work papers raises attorney-client privilege issues that would be associated with Commission staff conversations with external auditors. Outside counsel frequently speak with external auditors in the course of advising a broker-dealer with regard to its audited statements and annual audit. External auditors should be precluded from discussing advice provided by outside counsel with Commission staff.

C. The Commission Should Take Care to Ensure that the Proposed Rules Do Not Conflict with State Statutory Accountant-Client Privileges.

The Committee believes that there is a significant risk of potential conflict of law issues that could arise out of the Proposal. Many states have established statutory accountant-client privilege and/or confidentiality standards that protect the confidentiality of accountant-client materials and/or communications.[26] In addition, auditors are under ethical obligations, subject to certain exceptions, to maintain the confidentiality of their client's information.[27] Many accounting firms regard certain of their audit work papers and procedures as confidential and proprietary to themselves, because the work papers contain processes, forms, checklists, and procedures for performing audits that, to our knowledge, the accounting firms consider to be

---

[25] Proposing Release, Section III ("The Commission preliminarily intends that examiners generally would use any information obtained from audit documentation and discussions with the independent public accountants *to establish the scope and focus* of a pending examination of a clearing broker-dealer." (emphasis added))

[26] *E.g.*, Ala. Code § 34-1-21(a); Ariz. Rev. Stat. Ann. § 32-749; Colo. Rev. Stat. Ann. § 13-90-107-(1)(f)(I);Conn. Gen. Stat. Ann. § 20-281j; Fla. Stat. Ann. § 90.5055; O.C.G.A. § 43-3-32(b); Haw. Rev. Stat. § 466-12; Idaho R. Evid. 515(b); 225 Ill. Comp. Stat. Ann. 450/27; Ind. Code Ann. § 25-2.1-14-1; Kan. Stat. Ann. § 1-401; Ky. Rev. Stat. Ann. § 325.440; La. Rev. Stat. Ann. § 37:86; Me. Rev. Stat. Ann. tit. 32, § 12279; Md. Code Ann., Cts. & Jud. Proc. § 9-110; Mass. Gen. Laws Ann., ch. 112, § 87E; Mich. Comp. Laws Ann. § 339.732(1); Miss. Code Ann. § 73-33-16; Mont. Code Ann. § 37-50-402; Nev. Rev. Stat. Ann. § 49.185; N.H. Rev. Stat. Ann. § 309-B:18; N.M. Stat. Ann. § 38-6-6(c); N.D. Cent. Code § 43-02.2-16; Okla. Stat. Ann. tit. 12, § 2502.1; 63 Pa. Cons. Stat. Ann. § 9.11(a); Tenn. Code Ann. § 62-1-116; Vt. Stat. Ann. tit. 26, § 82; Wash. Rev. Code Ann. § 18.04.405.

[27] *See, e.g.*, American Institute of Certified Public Accountants Code of Professional Conduct, ET Section 301.01 ("A member in public practice shall not disclose any confidential client information without specific consent of the client, ...")

trade secrets that afford them a competitive advantage. At the very least, the Committee believes that the Commission must afford any audit documentation with confidential treatment and be responsible for returning all audit work papers to either the broker-dealer or its accounting firm.

III. PROPOSED FORM CUSTODY

Proposal. Currently, a broker-dealer's FOCUS report provides the SEC and the broker-dealer's DEA with information relating to the broker-dealer's financial and operational condition. The FOCUS report does not, however, solicit detailed information regarding where and how a broker-dealer maintains custody of assets. The third set of amendments are proposed to enhance the ability of Commission and DEA examiners to oversee broker-dealers' custody practices by requiring all broker-dealers to file a new Form Custody with their quarterly FOCUS reports. Form Custody will elicit information as to whether and how a broker-dealer maintains custody of cash and securities of customers and others. The majority of information solicited by Form Custody applies to a broker-dealer who either (i) holds customer accounts or (ii) clears transactions for itself or for accounts of other broker-dealers on a fully disclosed or omnibus basis.

Committee Comments.

A. The Rule Should Permit Commission Staff to Exempt Certain Broker-Dealers From the Filing Requirement.

The Committee believes that the rule should be amended to include a provision that authorizes Commission staff to exempt certain broker-dealers from the obligation to file Form Custody. As proposed, Form Custody is designed to gather information about the custody practices of carrying and clearing broker-dealers and broker-dealers that introduce accounts to other broker-dealers. The Committee believes that there are likely to be certain broker-dealers, such as principal underwriters and wholesalers, with respect to which Form Custody would serve no useful purposes, because the broker-dealer has no customer accounts and does not carry securities accounts for non-customers, does not act as a carrying broker-dealer for other broker-dealers and would not answer "yes" to any of the other items (Items 1-9) on Form Custody. In these circumstances, it seems appropriate the Commission staff should have the authority to exempt such a broker-dealer from an obligation to file Form Custody. Accordingly, the Committee requests that a provision be added to Rule 17a-5 that authorizes Commission staff to grant exemptions to the filing requirement. To require all broker-dealers to file Form Custody

without regard to the business model of the broker-dealer would not be an efficient use of either the Commission's or industry participants' resources.

IV. CONCLUSION

The Committee appreciates the opportunity to comment on the Proposal. We are happy to provide more specific input on the issues raised in this letter and answer any questions that the staff may have regarding our comments.

Please do not hesitate to contact Holly H. Smith (202.383.0245) or Michael B. Koffler (212.389.5014) if you have any questions regarding the issues addressed in this letter.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: _____
Holly H. Smith

BY: _____
Michael B. Koffler

FOR THE COMMITTEE OF ANNUITY INSURERS

APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

AEGON Group of Companies
Allstate Financial
AVIVA USA Corporation
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
(a Goldman Sachs company)
CNO Financial Group, 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)
SunAmerica Financial Group
Sun Life Financial
Symetra Financial
The Phoenix Life Insurance Company
TIAA-CREF
USAA Life Insurance Company