SIFMA
Securities Industry and
Financial Markets Association

January 29, 2008

By Telecopy and Overnight Mail

Ms. Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F St. NE
Washington D.C. 20549

Re: **File Number SR-FINRA-2007-040; FINRA Proposed Rule Change To Delay Implementation of Certain Provisions of Rule 2821**

Dear Ms. Morris:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to offer comment on the referenced rule filing by the Financial Industry Regulatory Authority, Inc. ("FINRA"), which seeks to make certain rule changes relating to sales practice and supervisory requirements for transactions in deferred variable annuities (DVA). Specifically, FINRA is proposing to delay the effective date of paragraph (c) of new Rule 2821 from May 5, 2008, until August 4, 2008, in order to address industry concerns about the principal review requirements contained therein, as well as FINRA's related interpretation in *Regulatory Notice 07-53*. All other parts of Rule 2821 will become effective, as scheduled, on May 5, 2008.

SIFMA commends the FINRA staff for their considerable and continued efforts to refine Rule 2821 in response to industry comment. We particularly appreciate FINRA's recognition of potential implementation concerns with respect to Paragraph (c) of the Rule and support a delay of the effective date as proposed.

As FINRA notes in its rule filing, member firms have identified three areas of concern relating to the application of Paragraph (c) that could result in potential unintended consequences to the detriment of investors, thus warranting further

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[1] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C. and London, and its associated firm, the Asian Securities Industry and Financial Markets Association, is based in Hong Kong.

consideration. These are: (i) the commencement of the seven-business day principal review and approval period from the time the customer signs the deferred variable annuity application; (ii) the ability of member firms to hold customer funds in "suspense" accounts at the insurer pending principal review of the client application; and (iii) the Rule's application to broker-dealers that do not make any recommendations to customers, and generally do not employ principals to perform suitability reviews.

I. Time Period for Principal Approval of Application

New Rule 2821(c) requires, in part, principal review and approval "prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days *after the customer signs the application.*" While SIFMA understands and shares FINRA's desire to foster prompt and fulsome principal review of DVA applications, we believe that commencing the seven day principal review period from the date the customer signs the application is highly problematic for several reasons. First, it incorrectly assumes that these two events will occur contemporaneously, or close in time, to one another. This is simply not the case. Often times, and through no fault of the member firm or its representative, the completed application reaches the designated branch office well after the client signed the application, thereby leaving little or no time for the principal to conduct the requisite review and approval. For example, it is not uncommon that a client signs an application and sends it to the representative via regular mail; or a client signs the application but delays delivering it to the representative or firm for several days or weeks; or the client inadvertently misdates the application. Under such circumstances, the firm will be forced to either reject an otherwise suitable DVA transaction while the representative obtains yet another client signature, thus delaying the client transaction further, or rush through the analytical review in order to meet the Rule's time period.

Second, even when the client transmits the signed application promptly to the branch office, there may be instances where the application packet is received "not in good order" ("NIGO"). Given the complexity of the DVA application submission process, it is not uncommon that during the principal review process, it becomes apparent that some of the information required by the application and related paperwork is incomplete or incorrect, thereby requiring registered representative follow-up. Currently, a DVA application packet requires, at minimum, three forms including a client profile, a suitability profile, and an application. Combined, these forms contain over one hundred data elements ranging from checking a box to documenting complex financial holdings. This does not include data elements found on conditional forms including variable annuities rider applications, replacement forms, state required forms and disclosures, and asset allocation program applications. The current formulation of the Rule simply does not accommodate the realities of the application process and unless modified could inadvertently penalize customers in the form of a rejected application because NIGO data elements could not be corrected and the application processed within the seven day window.

Finally, we note that many firms already have systems in place that track applications from the date of receipt at the branch office and not from the date the client signs the application. Tying the principal review for DVAs from the date the customer signs the application will cause a wholesale reworking of firms' existing systems and procedures, which we believe is unnecessary.

SIFMA respectfully suggests that a more practical and equally effective timing mechanism would be to commence the principal review period from the date the signed application is received in "good order" by the reviewing Office of Supervisory Jurisdiction ("OSJ"). Unlike the customer signature date, reliance on receipt date at the OSJ establishes an objective, consistent, easily verifiable timeframe for principal review.[2] To avoid undue delay in the processing of customer applications, member firms of course would have to have appropriate policies and procedures in place that are reasonably designed to ensure registered representatives promptly transmit applications to the appropriate branch office. Accordingly, SIFMA respectfully requests that FINRA modify the rule as suggested herein, a modification we believe preserves the Rule's investor protection objectives while avoiding many potential operational difficulties associated with the current form of the Rule.

II. Use of Suspense Accounts for Customer Funds Pending Principal Review

*Regulatory Notic*e 07-53 states that "when a captive broker-dealer and insurance company share office space and/or employees who carry out both the principal review and the issuance process," FINRA will deem the application "transmitted to the insurance company only when the broker-dealer's principal, acting as such, has approved the transaction provided that the affiliated broker-dealer ensures that arrangements and safeguards exist to prevent the insurance company from issuing the contract prior to principal approval by the broker-dealer."[3] The *Notice* further states, however, that Rule 2821 "does not permit depositing the customer's funds in an account at the insurance company prior to completion of the principal review."[4]

Broker dealers with insurance company affiliates typically have centralized units responsible for the variable annuity contract issuance process and often the processing of a wide variety of products, both fixed and variable. These units receive customer checks and review applications to ensure they are "in good order" for contract issuance. In many cases, an insurer's contract issuance unit is physically resident at the same location as one (or more) of the offices of the insurer's affiliated broker-dealer(s) and/or they share personnel with one another.

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[2] Receipt at the branch office would allow broker-dealers to use procedures already in place to time stamp applications, as well as audit the handling and transmittal of the applications at the branch office.

[3] FINRA Regulatory Notice 07-53, at page 6.

[4] Notice, footnote 21 at page 11.

As part of an insurer's overall financial controls, these centralized units maintain advanced systems to safely keep and monitor customer funds when received for the purchase of an insurance contract. Central to these controls are the maintenance of suspense accounts. Commonly used by life insurers since the 1970s, suspense account processing is an efficient and effective way to track customer funds and policy issuance status. It provides a level of financial controls that could not be achieved under prior procedures. Suspense accounts also routinely refund customer funds when a contract is not issued.

Although the SEC has granted a conditional exemption from certain custody and possession rules,[5] for broker-dealers that do not hold customer funds, but rather promptly transmit or deliver customer funds or securities to the appropriate issuer by noon of the next business day, the holding of customer funds creates significant compliance and operational challenges for securities firms. Accordingly, these broker-dealers may be forced to develop operational capabilities, controls, policies and procedures to now hold customer funds.

SIFMA respectfully requests that FINRA provide additional interpretative guidance that centralized units may deposit customer funds in the affiliated insurer's suspense accounts pending the principal's review required by the Rule in accordance with established procedures already in place at the insurance company. As described above, these procedures generally include holding and tracking such funds in a general suspense account, or in a segregated account, and refunding a customer's funds if an insurance contract is not issued.

III. Application of Rule 2821(c) to Firms That Do Not Make Any Recommendations

NASD 2821(c) provides for principal review of all variable annuity contracts whether or not recommended by the broker-dealer. As FINRA notes in the release, "some firms questioned whether broker-dealers that do not make any recommendations to customers (and generally do not employ principals to perform suitability reviews) should be subject to this provision." SIFMA shares this concern and respectfully requests that FINRA modify the Rule to exclude from the principal review requirements broker-dealers with the aforementioned business model.

IV. Conclusion

SIFMA appreciates the opportunity to comment on the proposed amendment. We applaud FINRA for their considerable efforts to promote appropriate investor protections in connection with deferred variable annuity transactions. SIFMA supports

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[5] SEC Rule 15c-3-3.

FINRA's proposed delay of the effective date of paragraph (c) of new Rule 2821 and respectfully requests that FINRA expeditiously modify the Rule as recommended herein. If you have any questions or require further information, please contact me at (212) 313-1212.

Respectfully submitted,

Amal Aly
Managing Director and
Associate General Counsel