

January 24, 2008

**VIA E-MAIL**

Ms. Nancy M. Morris  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

Re: **File Number SR-FINRA-2007-040; Notice of Filing of Proposed Rule Change To Delay Implementation of Certain FINRA Rule Changes Approved in SR-NASD-2004-183**

Dear Ms. Morris:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),<sup>1</sup> in connection with the Securities and Exchange Commission's (the "SEC's") Notice of Filing of Proposed Rule Change To Delay Implementation of Certain FINRA Rule Changes Approved in SR-NASD-2004-183. On November 6, 2007, the Financial Industry Regulatory Authority, Inc. ("FINRA") published Regulatory Notice 07-53, which announced the SEC's approval of Rule 2821 (the "Rule," or "Rule 2821") and established May 5, 2008 as the Rule's effective date.

FINRA is proposing that the effective date of paragraph (c) of the Rule ("Paragraph (c)") be delayed until August 4, 2008. This proposal is in response to the request of several firms that the effective date of this portion of the Rule be delayed to allow firms additional time to make necessary changes to comply with the Rule, and in order to allow FINRA to consider certain concerns raised regarding Paragraph (c). All other parts of the Rule will become effective as scheduled on May 5, 2008.

The Committee has played an active role during the development of Rule 2821, commenting on the original proposal and amendments as well as meeting with staff of both the SEC and FINRA at various junctures during the rulemaking process. The most recent of these meetings was held on December 20, 2007 where the Committee members

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<sup>1</sup> The Committee of Annuity Insurers is a coalition of 33 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over two-thirds of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

met with FINRA representatives to discuss the operational issues that are described in this letter. The Committee applauds the willingness of FINRA and the SEC to continue this dialogue with respect to certain issues raised related to Paragraph (c), and strongly supports the proposal to delay the effective date of that part of the Rule.

While the Committee wholeheartedly supports the intent of Rule 2821 to ensure that customers are protected and that only suitable sales are made, the two issues we discuss herein related to Paragraph (c) are operational in nature and, as we discuss, may potentially work against the protections of investors.<sup>2</sup> The first issue involves the time period for the broker-dealer's principal approval under Paragraph (c). The second issue involves a FINRA interpretative position which prohibits customer funds from being deposited in an insurer's account pending suitability sign-off in situations where customer funds are forwarded to an insurer's contract issuance unit which shares office space and/or personnel with an affiliated broker-dealer. We address each of these in turn below.

#### ***Time Period for Principal Approval of Application***

Paragraph (c) requires that a registered principal review a transaction and determine whether he or she approves of it prior to transmitting the customer's application to the issuing insurance company for processing, but no later than seven business days ***after the customer signs the application***. The Committee strongly believes that beginning the seven business day review period from the time when the customer signs the application is problematic in a number of ways. There are some situations where the timing requirement will be sufficient, particularly in situations where the registered representative has a face-to-face meeting with the client and obtains a fully and correctly completed application which includes the client's signature as well as payment. However, there are also many cases where it will be insufficient for a careful and thorough suitability review. The Committee's view is that the Rule's approach incorrectly assumes that a representative walks away with a signed application in all transactions, and that is not the exclusive manner in which variable annuity transactions are effected.

There are many situations where, through no lack of diligence on the part of the broker-dealer, the seven business day requirement measured from the date the customer signs the application will be problematic. By way of example, such situations will arise in cases where the customer signs the application and sends it to the representative via regular mail, where the client signs the application but delays delivering it to the representative or firm until days or even weeks later, or where the customer inadvertently uses an incorrect date. We also note that there is no practical way in which a broker-dealer can impose sound supervisory or audit controls over the date the customer signs the

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<sup>2</sup> In addition, the Committee supports FINRA's willingness to further explore the Rule's application to non-recommended transactions.

application.<sup>3</sup> This trigger date is outside the purview of the broker-dealer and is not subject to review in any practical manner. Finally, basing the seven business day requirement from the date of the customer signature will also be problematic in cases where it becomes apparent, during the process of review by the firm's registered principal, that some of the information required by the application and related paperwork has been submitted incompletely or incorrectly. This is due to the complexity of applications which typically reflect both securities and insurance requirements. We also note that Rule 2821 creates new obligations with respect to collection of data and documentation of recommendation and suitability review that will likely cause broker-dealers to need additional time to put the application in good order.

**Trigger Date.** The Committee recommends that the time period for the principal review should commence at a time that is easily verifiable and less prone to operational difficulties. The Committee believes that the Rule should be changed to start the seven day period at the time the broker-dealer receives the application at the Office of Supervisory Jurisdiction designated to review the completed variable annuity application ("OSJ"), and the application is in good order as defined by the broker-dealer. Using such OSJ receipt date as the trigger date sets an objective and clear time period and also allows broker-dealers to use procedures already in place to time stamp applications and to audit OSJ handling and transmittal. It will also ensure that customer applications are provided with a consistent length of time for principal review, in contrast to a trigger date that begins when the customer signs the application.

While the Committee urges using OSJ receipt as the trigger date, we do not suggest any tolerance for unreasonable delays by registered representatives in transmitting applications to the OSJ. In this connection, we note that registered representative handling of variable annuity applications would continue to be subject to FINRA review.

In addition, the Committee also requests confirmation that broker-dealers may continue to rely on the Net Capital Exemption granted by the SEC from certain requirements of Rules 15c3-1 and 15c3-3 under the Securities Exchange Act of 1934, following this change in the trigger date in Paragraph (c) of the Rule. Under Rules 15c3-1 and 15c3-3, a broker-dealer is deemed not to be carrying customer checks made out to a third party, for purposes of the net capital requirement and the requirement to maintain a customer reserve account, if it "promptly transmits" such checks to the third party by no later than noon of the next business day. The SEC granted an exemption from any additional requirements of Rules 15c3-1 and 15c3-3 with respect to transactions in deferred variable

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<sup>3</sup> In fact, the SEC referenced the concept of auditing to the date received rather than the date of the application in the exemptive relief from certain aspects of the net capital and customer protection rules provided to the industry in light of Rule 2821 stating that "a broker-dealer must maintain a copy of each such check and create a record of **the date the check was received from the customer** and the date the check was transmitted to the insurance company, if approved, or returned to the customer if rejected. **This requirement will allow the broker-dealer's compliance and internal audit departments as well as Commission, self-regulatory organization, and other examiners to verify that a broker-dealer is complying with the provisions of this exemption.**" Securities Exchange Act Release No. 56376 (Sept. 7, 2007) ("Net Capital Exemption") (emphasis added).

annuities where, in addition to meeting other conditions, “the transaction is subject to the principal review requirements of NASD Rule 2821 and a registered principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with that rule.”<sup>4</sup> The Committee requests that the SEC either confirm that broker-dealers may continue to rely upon the exemption in transactions involving a deferred variable annuity where a registered principal has completed his or her review in accordance with the Rule, as modified, or revise the exemption if necessary.

**Customer Consent to Delay.** In addition to the issues raised by the current trigger date for starting the review period, the Committee believes that there should be a process for addressing those infrequent situations when seven business days will not be a sufficient amount of time for the registered principal to conduct the required review. The Committee believes that the Rule should permit a broker-dealer to obtain the consent of the customer to delay the seven day period. We intend that this extension would be used infrequently, such as where a registered principal conducting a review needs further information or documentation from the selling representative or the customer. The Committee suggests that this exception could be patterned upon the provisions of Rule 22c-1 under the Investment Company Act of 1940.<sup>5</sup> Rule 22c-1 provides that, in complying with the “two day/five day” time period to price the payments under a variable annuity contract, the insurance company may, if the application for the variable annuity is incomplete, refrain from returning the initial purchase payment when the two day/five day period expires if “the prospective purchaser specifically consents to the insurer retaining the purchase payment until the application is made complete.”<sup>6</sup> Under Rule 22c-1, the prospective purchaser must be informed of the reasons for the delay in pricing the contract.

The Committee believes that Rule 2821 should be amended to provide that the broker-dealer can request that the customer consent to a delay in the seven day review period to allow the broker-dealer to complete the required review, and if applicable, the broker-dealer will appropriately document such customer’s consent. The broker-dealer would be required to inform the customer of the reasons for the delay. This would allow the customer to determine if he or she prefers to have the application returned along with any funds sent with it, or instead allow the review process to continue.

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<sup>4</sup> Securities Exchange Act Release No. 56376 (Sept. 7, 2007).

<sup>5</sup> The provisions of Rule 22c-1 relating to the two day/ five day procedure and the possibility of the customer consenting to a delay were adopted by the SEC in 1985, and have worked well for both customers and the industry for over twenty years.

<sup>6</sup> Rule 22c-1(c)(2).

### *Use of Suspense Accounts for Customer Funds During Processing of Application*

Virtually all insurance companies have centralized units that are 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 make sure that 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.

As part of an insurer's overall financial controls, these centralized units maintain advanced systems to safe keep and monitor customer funds when received for the purchase of an insurance contract. Central to these controls are the maintenance of suspense accounts. Suspense account processing has been utilized by life insurers since the 1970s. A suspense account is best viewed as a tracking account or a clearing account used to hold and identify money received pending contract issuance. The suspense accounts use systems to track funds and policy issuance status, and make processing of customer funds much more efficient and effective and provide a level of financial controls that could not be achieved under prior procedures. In addition, suspense accounts routinely refund customer funds when, for whatever reason, a contract is not issued.

FINRA's Regulatory Notice 07-53 (the "Notice") deals with interpretative questions that have been raised with respect to situations in which an insurer's contract issuance unit and affiliated broker-dealer share office space and/or personnel. The Notice 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."<sup>7</sup> However, the Notice goes on to state that the Rule "does not permit depositing the customer's funds in an account at the insurance company prior to completion of the principal review."<sup>8</sup>

The Committee urges 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.<sup>9</sup> As described above, these procedures generally include holding and tracking such funds in a general suspense

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<sup>7</sup> FINRA Regulatory Notice 07-53, at page 6.

<sup>8</sup> *Id.* footnote 21 at page 11.

<sup>9</sup> Given the significant financial control-related issues raised by holding customer funds during the suitability review period, the staff may want to consider whether the use of such suspense accounts should be considered *even* for variable annuity transactions that do not involve an insurer's affiliated broker-dealer that shares office space and/or personnel with such insurer.

account or in a segregated account, and refunding a customer's funds if an insurance contract is not issued.

In contrast, if the use of suspense accounts is not permitted, the centralized units will be required to establish a procedure to maintain and track paper checks in vaults, safe deposit boxes, or other physical storage locations, and will prevent companies from using technology as effectively as they can. Firms' auditors will also take a dim view of this practice, which is inconsistent with generally accepted best practices with respect to the handling of customer funds. In short, investor interests will not be served by requiring that funds received pending the Rule's suitability sign-off be held separately and tracked and monitored differently than other customer funds. In addition, the cost to insurers in developing separate procedures will be significant.

Further, allowing funds to be maintained in accordance with established procedures at the insurer will not run counter to any policy being advanced by the Rule. The use of suspense accounts will not result in the issuance of a contract, and will not affect the nature of the review by the principal of the broker-dealer. In addition, insurance companies have strong controls in place to ensure that payments are returned to customers from suspense accounts as necessary to comply with various regulatory requirements, such as the free look requirements under state insurance laws and the good order processing requirements under Rule 22c-1 under the Investment Company Act. Further, we note that the controls in place with respect to insurer maintenance of funds prior to issuance of a variable product is an area that receives significant scrutiny by examiners during SEC separate account examinations and is also subject to examination by state insurance departments.

#### CONCLUSION

The Committee appreciates the opportunity it has had to comment on the proposed Rule Amendment. We would look forward to a meeting with the staff in order to provide more specific input on the issues raised in this letter and answer any questions the staff may have.

Respectfully Submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: Clifford Kinosh /wv

BY: Eric Arnold /wv

FOR THE COMMITTEE OF ANNUITY  
INSURERS

Ms. Nancy M. Morris  
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cc: The Honorable Christopher Cox  
The Honorable Paul S. Atkins  
The Honorable Kathleen L. Casey  
The Honorable Annette L. Nazareth  
Erik R. Sirri, Division of Trading and Markets  
Andrew J. Donohue, Division of Investment Management  
  
James S. Wrona, FINRA

APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

AEGON USA, Inc.  
Allstate Financial  
AIG Life Insurance Companies  
AmerUs Annuity Group Co.  
AXA Equitable Life Insurance Company  
Commonwealth Annuity and Life Insurance Company  
Conseco, Inc.  
Fidelity Investments Life Insurance Company  
Genworth Financial  
Great American Life Insurance Co.  
Guardian Insurance & Annuity Co., Inc.  
Hartford Life Insurance Company  
ING North America Insurance Corporation  
Jackson National Life Insurance Company  
John Hancock Life Insurance Company  
Life Insurance Company of the Southwest  
Lincoln Financial Group  
MassMutual Financial Group  
Merrill Lynch Life Insurance Company  
Metropolitan Life Insurance Company  
Nationwide Life Insurance Companies  
New York Life Insurance Company  
Northwestern Mutual Life Insurance Company  
Ohio National Financial Services  
Old Mutual Life Insurance Company  
Pacific Life Insurance Company  
Protective Life Insurance Company  
Prudential Insurance Company of America  
RiverSource Life Insurance Company  
*(an Ameriprise Financial company)*  
Sun Life Financial  
Symetra Financial  
The Phoenix Life Insurance Company  
USAA Life Insurance Company