SUTHERLAND

Grace Building
1114 Avenue of the Americas, 40th Floor
New York, NY 10036-7703
212.389.5000 Fax 212.389.5099
www.sutherland.com

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July 1, 2008

VIA E-MAIL

Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: **File Number SR-FINRA-2008-019: Notice of Filing of Proposed Rule Change Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities**

Dear Ms. Harmon:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),[1] in connection with the Notice of Filing of Proposed Rule Change Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities submitted by the Securities and Exchange Commission ("SEC"). The filing would make a number of changes to NASD Conduct Rule 2821 including:

- changing the trigger date for the beginning of the principal review period to run from the date when an office of supervisory jurisdiction of the firm receives a complete and correct copy of the application; and

- clarifying a number of issues through a "Supplementary Material" section following the rule's text including the circumstances in which members may forward funds to insurance companies for deposit in the companies' suspense accounts.

The Committee is very pleased with the developments related to the trigger date for principal approval and suspense accounts in the rule filing. In particular, the Committee lauds the staff of the SEC and the Financial Industry Regulatory Authority ("FINRA") for reacting to industry comments, including from the Committee, in determining to re-examine its analysis of the limitations initially imposed on the use of

[1] 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.

suspense accounts. The Committee has appreciated the willingness of both FINRA and the SEC to listen, and respond in a reasonable manner, to concerns about this rulemaking over its four year history.

This letter addresses comments from the Committee regarding the following two aspects of the proposal: (i) the trigger date for principal approval; and (ii) the circumstances under which an insurer may hold customer funds in advance of the broker-dealer completing the suitability review.

TRIGGER DATE FOR PRINCIPAL APPROVAL

The Committee supports the proposal to start the seven day principal approval period when a broker-dealer receives a "correct and complete" application at an office of supervisory jurisdiction ("OSJ") of the firm. This standard is workable and should generally provide sufficient time for principal review.

The Committee does, however, seek clarification that the trigger date does not begin when an application is received at *any* OSJ of the firm. Rather, in order to be "correct and complete" the application must be received at the particular OSJ designated by the firm for processing such applications.

The Committee also suggests that the Rule be revised to address infrequent situations when seven business days will not be a sufficient amount of time for the registered principal to conduct the required review. For example, we anticipate that there will be limited situations where a "complete and correct" application is received but a registered principal conducting a review needs further information or documentation from the selling representative or the customer. In order to address such situations, the Committee believes that the Rule should permit a broker-dealer to obtain the consent of the customer to delay the seven day period so that the broker-dealer may conduct a suitability review that satisfies the substantive standards set forth in Rule 2821. As we have discussed in a previous comment letter, this exception could be patterned upon the provisions of Rule 22c-1 under the Investment Company Act of 1940.[2] As such, 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

[2] 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. 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." Under Rule 22c-1, the prospective purchaser must be informed of the reasons for the delay in pricing the contract. *See* Comment Letter from the Committee of Annuity Insurers to Nancy M. Morris, SEC, File Number SR-FINRA-2007-040 (Jan. 24, 2008) ("2008 Comment Letter").

continue. Further, the broker-dealer would be required to maintain proper documentation related to the customer's consent.

SUSPENSE ACCOUNTS

While Rule 2821 itself does not expressly prohibit the forwarding of customer funds by a broker-dealer to an insurer prior to the completion of its suitability review,[3] FINRA's Regulatory Notice 07-53 rejected the use of insurance company suspense accounts to hold customer funds prior to a member's suitability review.[4] The proposed Rule 2821 Supplementary Material .03 ("SM.03") [5] would modify that position to allow the use of such suspense accounts under certain circumstances. In particular, SM.03 requires that (1) the member must disclose to the customer the transfer of funds, and (2) the member must enter into a written agreement with the insurance company related to the use of the suspense account. Under SM.03, the written agreement must specify that the insurer agrees:

- To segregate the members' customers funds in a bank in an account equivalent to the deposit of funds by a member in a "Special Account for the Exclusive Benefit of Customers" as described under Rules 15c3-3(k)(2)(i) and 15c3-3(f) of the Securities Exchange Act of 1934 (the "1934 Act");
- Not to issue the variable annuity contract prior to the completion of the suitability review; and
- To promptly return customer funds at the customer's request prior to the member's principal approval, or upon the member's rejection of the application.

As discussed below, some Committee members have expressed the preliminary view that, with minor changes, the terms of SM.03 may be workable. We also discuss the financial and operational burdens imposed under SM.03 that, for other members of the Committee, appear to make the changes required too costly or administratively burdensome to implement. We also review the operation and controls over suspense accounts that call into question the need for the SM.03 requirements. Finally, given the myriad issues insurance companies are discovering as they work through the complicated and time consuming process of evaluating potential changes that could be required to implement Rule 2821, the Committee believes strongly that if FINRA decides to advance SM.03, it should provide expressly for alternative options that would permit member firms to transmit funds to an insurance company utilizing a suspense account.

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[3] Rule 2821(c) only addresses the forwarding of the "application" prior to the completion of the suitability review, and does not expressly address forwarding customer funds, nor does it define the term "application" to include such funds.

[4] FINRA Regulatory Notice 07-53 at n. 21.

[5] "Supplemental Materials" are a new concept introduced by FINRA as part of its rulebook consolidation initiative. It is unclear whether the proposed Rule 2821 Supplementary Materials have the same force as Rule 2821. The Committee requests clarification on this point.

SUGGESTED REVISIONS TO SM.03

The Committee suggests an important revision with respect to the language in SM.03 that could help to address certain implementation challenges. The Committee believes that the conclusion of clause 2(a) of SM.03 should be deleted and should read in its entirety as follows:

> (a) segregate the member's customers' funds in a bank in an account equivalent to the deposit of those funds by a member into a "Special Account for the Exclusive Benefit of Customers" (set up as described in SEA Rules 15c3-3(k)(2)(ii) and 15c3-3(f)).

The Committee believes that this formulation appropriately creates a level playing field for the manner in which a broker-dealer is required to hold funds, and the manner in which an insurance company would now be required to hold funds prior to issuance of a variable contract.

Further, the Committee requests clarification that the customer disclosure called for by .03 is the responsibility of the member firm and that it –as opposed to an insurer- is responsible for ensuring timely delivery of this information. Further, the Committee seeks clarification that an insurer's duty to promptly return deposits from a suspense account may be satisfied by returning such funds to the selling member firm.

THE FINANCIAL AND OPERATIONAL BURDENS ASSOCIATED WITH SM.03

In response to the latest FINRA proposal, Committee members have made a concerted effort to research the manner in which their funds handling, administrative operations, computer systems and banking relationships may need to be changed to accommodate the requirements imposed under SM.03 for holding customer funds. It has been difficult to reach definitive conclusions on many of these issues within the aggressive 21-day deadline for comment under the most recent proposal, particularly given that the issues raised typically run across many different functional areas of an insurance company. As might be expected, the amount of resources required to convert existing practices with respect to collecting variable annuity purchase payments differs from company to company depending on a number of factors, including the current data processing systems, existing banking relationships and accounting and cashiering systems. Some members view the resource burden of converting the funds handling process to comply with SM.03 as significant and estimate that out-of-pocket expenses for modifying systems and processes could cost well over $1,000,000 per firm. These figures do not include "soft" costs such as training and the general dislocation of standard routines for processing business.

As the Committee has commented in the past, insurance companies have a long history of holding customer funds pending issuance of contracts, including variable

annuity contracts, in a suspense account.[6] The Committee believes that the protections afforded under the insurance laws to such funds have historically been strong, and the results of the more recent insurance company insolvencies reflect that treatment. The Committee also believes that the existing structure for handling variable annuity purchase payments provides an appropriate and adequate level of protection to customer funds, and has functioned effectively, without loss of any customer funds prior to the issuance of a variable annuity contract over the last four decades. Existing suspense account practices provide significant protection to customer funds and are subject to scrutiny by state insurance regulators, internal auditors and SEC examinations of variable annuity separate account operations. In this connection, we note that the Commission's recent release on indexed annuities notes the robust nature of state insurance regulation over insurers' financial controls. [7] Given these considerations, before finalizing SM.03 we urge that the SEC and FINRA engage in a constructive dialogue with state insurance regulators on the operation of suspense accounts and the treatment of funds held in suspense under state insurance laws. We also note that some members of the Committee are interested in providing research and other background on these matters if it would be helpful to the SEC and FINRA in advancing consideration of this important issue. Such research could include examining protections afforded funds held in suspense in the context of insurance company insolvency.

Given the potential costs of assessing and potentially re-doing the existing suspense account practices, and the longstanding history of successful operation of suspense accounts, the Committee believes that a compliance date for the new Rule 2821 and Supplementary Material should be no less than 18 months from the date the final rule is adopted. Committee members will need that time to assess their existing systems, evaluate their options, and then implement changes if required. In addition, as described in more detail below, the Committee believes that FINRA ought to provide an option that would allow for new or innovative techniques to be used with respect to suspense accounts that provide efficient and cost effective alternatives for insurance companies, while providing FINRA with a level of comfort that customer funds are being protected.[8]

ADDITIONAL OPTIONS

Given the difficulties in assessing the costs of changing existing suspense account operations and the potential options, the Committee feels strongly that FINRA should

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[6] 2008 Comment Letter. The Committee notes that the 2008 Comment Letter provides a detailed description of the operation of suspense accounts.

[7] Release Nos.33-8933, 34-58022, Indexed Annuities and Certain Other Insurance Companies (June 25, 2008), notes 76-77 and accompanying text (reviewing state insurance regulation over insurers' financial controls and noting that given the comprehensiveness of such requirements, an exemption for insurers from Exchange Act reporting would be appropriate).

[8] While not entirely clear, our understanding is that FINRA views the holding of customer funds in the suspense account as putting inappropriate pressure on a broker-dealer to determine that a recommendation is suitable. The Committee disagrees with this assumption.

provide expressly for alternative options that would permit member firms to transmit funds to an insurance company utilizing a suspense account. Such alternative options could be provided directly in the rule or through an express exemptive process in Rule 2821 that would allow for particular suspense account processes to be reviewed and permitted notwithstanding that the funds could be deemed to be transmitted to the insurer in advance of the member firm's suitability review. The Committee believes that allowing for particularized, fact specific, exceptions is a logical response given the difficulty that Committee members have had, despite dogged efforts, to create a "one size fits all" solution to the suspense account issue. In particular, the Committee identifies the following examples of certain approaches that its members are considering:

Alternative – Reserve Bank Account. Some Committee members would like to propose an alternative account structure under which the issuing insurance company could hold customer funds in advance of principal approval by the member firm. Since FINRA has proposed, under SM.03, that an insurance company could make use of a bank account to segregate customer funds in an account "equivalent" to a k(2)(i) Account, the Committee proposes that an insurer should also be permitted in the alternative to hold customer funds in an account similar in form and function to a Reserve Bank Account under Rule 15c3-3(e). Some Committee members have found in their assessment of the potential alternative options to existing suspense accounts that creating an account that functions like the Reserve Bank Account may be significantly less expensive in terms of upfront resources and ongoing costs to operate than other options. Since both k(2)(i) Accounts and Reserve Bank Accounts are subject to the same bank notification requirements and general features under Rule 15c3-3(f), many of the same customer protections would be in place.

The operational challenges which would be faced by an insurance company suspense account structure required to be maintained in the equivalent of a k(2)(i) Account are not dissimilar to those faced by a broker-dealer relying on k(2)(i) accounts where such broker-dealer receive large volumes of payments from their customers. For example, the maintenance of such an account would require that the insurance company create a workflow process to separate out checks from customers purchasing variable annuities for which suitability review has not yet been completed, and to deposit them in a special account. The existing SEC customer protection rule requirements for broker-dealers, by contrast, appear to recognize the operational difficulties of separating customer check receipts into those requiring 15c3-3 protection and those not requiring such protection.[9] Accordingly, fully computing firms are not required to segregate customer checks prior to the check deposit. Instead, such firms may determine that they will maintain a deposit in a Reserve Bank Account at least equal to the periodically

[9] For example, personnel of a fully-computing broker-dealer who are responsible for the depositing of inbound checks need not segregate bank deposits into payments from customers versus persons who are not "customers" (as defined in Rule 15c3-3(a)(1), or securities customers versus commodities customers, or customer checks which result in a "free credit balance" (as defined in Rule 15c3-3(a)(8)) versus customer checks in payment of existing obligations to the broker-dealer.

calculated amount of net customer liabilities which warrant protection under Rule 15c3-3. Rule 15c3-3 provides deadlines regarding the calculation of the required deposit and the timing of such deposit, in addition to limitations as to any withdrawal from such Reserve Bank Account.

If FINRA permitted the use of an insurance company account modeled after the Reserve Bank Account, it would allow the insurance company to periodically calculate the amount of checks received from variable annuity customers for which a variable annuity contract had not yet been issued. In particular, this approach could reduce the scope of changes to cashiering procedures that could be required under SM.03. As with SM.03, the broker-dealer and the insurance company could enter into a written agreement that the insurance company would maintain a deposit in a Reserve Bank Account in an amount at least equal to the total of such customer checks received. This agreement would be maintained by the broker-dealer and could be reviewed by FINRA and the SEC. Since Rule 2821 is overlaying significant obligations on insurers as if they were broker-dealers, it only seems appropriate that insurers be provided with options similar to those available to broker-dealers to safekeep customer funds.

ALTERNATIVE- OBTAINING STATE INSURANCE REGULATORY AUTHORITY GUIDANCE. Some Committee members would like to propose an exception from the SM.03 requirements where a member firms delivers guidance from the insurance regulatory authority of a particular insurance company's state of domicile indicating the manner in which the applicable insurance regulatory authority would treat suspense account funds in the event of an insolvency. If FINRA reviews such guidance and a description of the operations of the suspense account and believes that the protections afforded under state insurance laws meet its investor protection standards, FINRA would provide an exemption from Rule 2821 that would permit handling variable annuity customer funds as described under the guidance.

CONCLUSION

The Committee appreciates the opportunity it has had to comment on proposed Rule 2821. 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 Hirsch/de

BY: Eric Arnold/de

FOR THE COMMITTEE OF ANNUITY INSURERS

cc: The Honorable Christopher Cox
The Honorable Paul S. Atkins
The Honorable Kathleen L. Casey

Erik R. Sirri, Division of Trading and Markets
Lourdes Gonzales, Division of Trading and Markets
Michael Macchiaroli, 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