

February 18, 2009

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

**Re: File No. SR-FINRA-2008-067
Notice of Filing of Proposed Rule Change to Adopt Rules Governing
Financial Responsibility in the Consolidated FINRA Rulebook**

Dear Ms. Murphy:

This letter is submitted on behalf of the Committee of Annuity Insurers (“Committee”)¹ in response to the Securities and Exchange Commission’s (the “Commission” or “SEC”) publication of, and request for comments on, File No. SR-FINRA-2008-067 *Notice of Filing of Proposed Rule Change To Adopt Rules Governing Financial Responsibility in the Consolidated FINRA Rulebook* (the “Rule Change Proposal”).² The Committee appreciates the opportunity to comment on the proposed rules.

Our comments begin with a discussion of the proposed definition of “carrying or clearing” firm because this definition is central to several of the issues raised in the Commission’s request for comments and in FINRA’s request for comments on other, related financial and operational rules.³

¹ The Committee of Annuity Insurers is a coalition of 30 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 Committee members is attached at Appendix A.

² File Number SR-FINRA-2008-067 was published in SEC Release No. 34-59273, 74 Fed. Reg. 4992 (Jan. 28, 2009).

³ See FINRA Regulatory Notice 09-03 *Financial Responsibility and Related Operational Rules* (Jan. 2009), wherein FINRA proposes to adopt new rules 4150, 4311, 4522 and 4523 (hereafter “Notice 09-03”). The Committee will comment separately on Notice 09-03.

The Definition of “Carrying or Clearing” Firm

As you know, many of the rules in the Rule Change Proposal make a distinction between member firms that clear or carry customer funds or securities and firms that do not. We understand that FINRA is trying to establish “tiers” of firms for different purposes in recognition of the fact that different firms may have fundamentally different business models and operations. Toward this end, FINRA has proposed financial responsibility rules that would place greater regulatory responsibilities on carrying and clearing firms and firms that operate pursuant to the exemptive provision provided in SEC Rule 15c3-3(k)(2)(i). For example, under the proposed rules FINRA can require carrying and clearing members and (k)(2)(i) firms to maintain greater net capital or net worth than is required by the Net Capital Rule;⁴ FINRA can prohibit carrying and clearing firms and (k)(2)(i) firms from withdrawing capital in excess of 10 percent of a firm’s excess net capital without FINRA’s prior consent,⁵ and carrying, clearing and (k)(2)(i) firms generally would be required to create and keep additional books and records.

The distinction FINRA proposes to make between carrying and clearing firms and non-carrying and clearing firms was first introduced in FINRA Regulatory Notice 08-23.⁶ In that notice, FINRA stated that certain of its proposed rule provisions would apply only to those firms that clear or carry customer accounts or that operate pursuant to the exemptive provisions of SEC Rule 15c3-3(k)(2)(i). FINRA also stated that rules applicable to carrying, clearing and (k)(2)(i) firms would not apply to introducing firms or to firms with limited business models (together, FINRA defined such firms as “non-clearing firms”). In a parenthetical, FINRA explained that introducing firms and firms that engage exclusively in subscription-basis mutual fund transactions, direct participation programs, or mergers and acquisitions activities would not be subject to rules applicable to carrying, clearing and (k)(2)(i) firms.

In a comment letter the Committee submitted in response to Notice 08-23, the Committee questioned why member firms that rely on the (k)(2)(i) exemption should be subject to the same rules as carrying and clearing firms and pointed out that the risks generated by the activities of a (k)(2)(i) firm can be significantly different than those of carrying and clearing firms.⁷ Other commenters also questioned why member firms that rely on the (k)(2)(i) exemption would be subject to the same rules as carrying and clearing firms even though some (k)(2)(i) member firms

⁴ See Proposed FINRA Rule 4110.

⁵ See *id.*

⁶ Regulatory Notice 08-23 (May 2008) (hereafter “Notice 08-23”); the rules discussed in Notice 08-23 form the basis for the Rule Change Proposal.

⁷ See letter submitted by Sutherland on behalf of the Committee of Annuity Insurers in response to Notice 08-23, dated June 13, 2008, available at <http://www.finra.org/Industry/Regulation/Notices/2008/P038501>.

do not engage in carrying or clearing activities.⁸ The Committee also asked for clarification regarding when a firm might be deemed to be a (k)(2)(i) member.

In response to the comments it received on Notice 08-23, FINRA clarified that a (k)(2)(i) firm would be included as a clearing or carrying member for purposes of the proposed rules if the firm either holds customer funds in a bank account established pursuant to Rule 15c3-3(k)(2)(i) or clears customer transactions through such an account. FINRA did not explain, however, why it believes all (k)(2)(i) members present a business and risk profile comparable to traditional carrying and clearing firms, *i.e.*, firms that do not rely on any of the exemptive provisions in Rule 15c3-3, paragraph (k).

The Committee appreciates FINRA's efforts to draw meaningful distinctions among the different types of firms it regulates. These distinctions are extremely important for many reasons, including the fact that they assist the Commission and FINRA in identifying business models that increase the risk of loss of customer assets or other customer harm. The Committee fully supports FINRA's efforts in this regard.

The Committee believes, however, that FINRA's definition of "carrying or clearing" firm should be revised in two respects.

First, we believe that FINRA should include firms distributing variable annuities or life insurance ("variable products") (in the capacity of principal underwriters, wholesalers or selling firms) within the types of firms FINRA has described as having "limited business models." Firms distributing variable products, are, like mutual fund distributors, operating limited business models, and these business models are vastly different than the models employed by traditional clearing and carrying firms. Like mutual fund distributors, distributors of variable products typically require that customers make their checks payable to the issuer, not the introducing firm.⁹ Accordingly, FINRA's reference to firms with limited business models should include variable product distributors.

Second, the Committee believes that FINRA should take into consideration the extremely different profile of firms that use the exemption provided in SEC Rule 15c3-3(k)(2)(i) versus the

⁸ See, e.g., letter submitted by ING Advisors Network noting that (k)(2)(i) firms have a reduced operating risk (June 13, 2008); and letter from Stephen R. Kinkade, questioning FINRA's rationale for including (k)(2)(i) firms in the same tier as carrying and clearing firms (June 13, 2008). Both letters are available at: www.finra.org/Industry/Regulation/Notices/2008/P038501.

⁹ Introducing firms that sell variable products (like mutual fund distributors) use the "check and application" business model and do not typically deposit customer funds into segregated accounts established for a customer's benefit.

profile of traditional carrying and clearing firms. A firm that uses the (k)(2)(i) exemption by definition is complying with the SEC's "prompt" forwarding requirement, which as you know requires such firms to forward customer funds and securities by noon of the next business day following receipt. To the extent such firms actually hold customer funds in a Special Account For the Exclusive Benefit of Customers, the amounts so held, and the duration of the holding, is unlikely to be comparable to the amounts held by traditional carrying and clearing firms. FINRA has indicated that there are seventy firms that come within the (k)(2)(i) exemption; we would be interested in learning from FINRA what its data shows with respect to the amount of customer money held by such firms in their Special Accounts and the duration of the holding period. We believe this data would be helpful in assessing the appropriateness of treating all (k)(2)(i) firms in the same manner as carrying and clearing firms.

Proposed FINRA Rule 4110 (Capital Compliance)

Proposed FINRA Rule 4110 would permit FINRA to establish greater net capital or net worth requirements for carrying, clearing and (k)(2)(i) members after FINRA issues a notice to the member firm. Member firms would have a right to express their concerns at an expedited hearing before the new capital/net worth requirement takes effect. The proposed rule would also: (i) require any member firm not in compliance with the Net Capital Rule to suspend all business operations; (ii) prohibit members from withdrawing equity capital for one year; and (iii) prohibit carrying, clearing and (k)(2)(i) firms from withdrawing any equity capital, paying a dividend or making a similar distribution, if such withdrawal(s) in any rolling 35 calendar day period would exceed 10 percent of the firm's excess net capital.

The proposed rule also would prohibit carrying, clearing and (k)(2)(i) members from entering into sale-and-lease back or similar arrangements with respect to any of a firm's assets or any unsecured accounts receivable, where such arrangement would increase the firm's tentative net capital by 10 percent or more, without FINRA's prior written approval.¹⁰

FINRA has stated that it intends to use its authority to require a greater net capital or net worth requirement "judiciously."¹¹ While we trust that this is FINRA's intent, we note that

¹⁰ Other provisions of Proposed FINRA Rule 4110 would prohibit certain sale or factoring arrangements involving customer debit balances, without FINRA's advance approval; limit loan agreements that involve the firm's fixed assets and other assets not readily converted into cash; estop member firms from determining that a "ready market" exists for securities based on the securities being accepted as collateral for a loan by a bank, unless FINRA agrees to "ready market" status; permit FINRA to impose conditions that go beyond the stated requirements of the Net Capital Rule on subordinated loans and other financing arrangements; and require FINRA approval for capital contributed to a firm by a general partner if the source of the capital is the proceeds of a loan made to the general partner.

¹¹ Proposed FINRA Rule 4110(a) at 74 Fed. Reg. 4997.

member firms are accustomed to following internal control guidelines that key off of established numeric thresholds (for example, the thresholds established by the Net Capital Rule). If member firms were to have to guess at amounts of capital that they should keep on hand in case FINRA requires a greater capital commitment than is required by the Net Capital Rule, firms will inevitably have greater difficulty operating their businesses and may end up tying up capital that should serve other purposes. Accordingly, the Committee believes that FINRA should build objective standards into the phrase used in Proposed Rule 4110(a), “when necessary for the protection of investors or in the public interest,” to ensure that firm’s have some predictability in their cash management functions and so that this standard is applied equitably to all FINRA members.

The Committee also has concerns regarding FINRA’s proposal to require carrying, clearing and (k)(2)(i) firms to obtain written approval from FINRA prior to withdrawing capital in excess of 10 percent of the firm’s excess net capital. This requirement is a significant departure from existing SEC rules and it is unclear why FINRA needs a separate (and different) requirement in this regard. If FINRA believes that it must establish a pre-approval requirement, then it needs to give member firms certainty regarding how long firms will have to wait for FINRA’s approval. FINRA has stated that its decision “typically would be issued in approximately three business days.”¹² Firms need to know in advance the maximum number of days for FINRA’s review because of the many timing issues involved in a distribution, *e.g.*, board approval, capital calculations, comparison with the firm’s most recent FOCUS Report. We also request that FINRA apprise member firms whether the staff’s review and decision will be based on capital calculated as of the date when the request is filed, or whether FINRA would require a firm to re-compute capital while the request is pending.

The Committee would also like to understand the interplay between SEC Rule 17a-11 and the requirement in Proposed Rule 4110 that member firms cease all business operations upon discovering that the firm is not in compliance with the Net Capital Rule. Current practice in the industry is that firms file a Rule 17a-11 notice upon discovering or being informed of a potential violation of the Net Capital Rule. Firms do not cease all operations. Many violations of the Net Capital Rule do not indicate that a firm is in financial or operational difficulty; in fact, a firm may have excess net capital notwithstanding a Net Capital Rule violation. In addition, firms often learn of a potential Net Capital Rule violation after-the-fact, *i.e.*, the potential violation occurred in the past and the firm currently is not in violation of the rule. There are also customer protection issues that need to be considered: would ceasing all business operations mean that the member firm should refuse to execute a sell order even though it is in the customer’s best interest and the firm is in possession of the customer’s securities?

¹² Proposed FINRA Rule 4110(c)(2) at 74 Fed. Reg. 4998.

In view of the issues raised above, the Committee believes it would be appropriate to revise the proposed rule to take into account whether the Net Capital Rule violation actually results in the broker-dealer currently being under-capitalized and is a continuing condition. In addition, we believe it would be helpful if FINRA explained the process and the timeline that member firms would be required to follow when suspending all business operations. For example, the rule language says “[u]nless otherwise permitted by FINRA, a member shall suspend all business operations [during any period in which it is not in compliance with the Net Capital Rule].” It is unclear whether FINRA intends that member firms first contact FINRA staff to request that the firm be permitted to stay in operation, and if such a request is required to be made, firms need to know exactly to whom the request should be made. FINRA should identify specific staff with authority to respond to these requests in a timely manner.

Proposed FINRA Rules 9557 (Procedures for Regulating Activities Under Rules 4110, 4120 and 4130 Regarding a Member Experiencing Financial or Operational Difficulties) and 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series)

Finally, we would like to comment on one of the proposed timeframes set forth in Proposed Rule 9559. Paragraph (h) of this rule would permit FINRA to withhold from member firms any or all of the documents on which FINRA relied in imposing restrictions on the member until two business days before the hearing. Since FINRA will be the party that imposed the restrictions, it presumably has good evidence to support the restrictions well before the hearing date. In these circumstances, not providing these documents to member firms as soon as a hearing is requested puts the member firm at a disadvantage, for no regulatory purpose. While we recognize that FINRA is trying to establish an expedited process for handling these types of cases, the process needs to present both FINRA and member firms with a fair opportunity to present their cases.

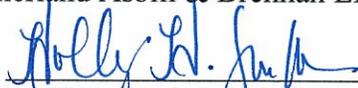
We also note that the Hearing Panel will have no authority to *modify* any of the restrictions or limitations FINRA imposed through the notice served on the member firm; the Hearing Panel would be authorized only to approve or withdraw the requirements and/or restrictions imposed by the notice. The inability of the Hearing Panel to modify the restrictions would seem to limit the usefulness of the Hearing Panel, and FINRA has not explained why the Hearing Panel needs to be so restricted in its authority.

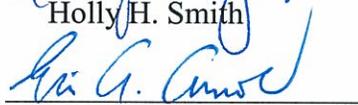
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Thank you for your consideration of these comments. If you have any questions regarding this letter, please contact the undersigned at (202) 383-0100.

Sincerely,

Sutherland Asbill & Brennan LLP

By: 
Holly H. Smith

By: 
Eric A. Arnold

For The Committee of Annuity Insurers

APPENDIX A

AEGON Group of Companies
Allstate Financial
AVIVA USA Corporation
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
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)
Sun Life Financial
Symetra Financial
USAA Life Insurance Company