

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60086; File No. SR-FINRA-2009-023)

June 10, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Adopt FINRA Rule 2320 in the Consolidated FINRA Rulebook

I. Introduction

On March 31, 2009, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt NASD Rule 2820 as FINRA Rule 2320 in the consolidated FINRA rulebook (“Consolidated FINRA Rulebook”)³ with minor changes. The proposal was published in the Federal Register on April 21, 2009.⁴ The Commission received one comment letter on the proposal.⁵ On June 1, 2009, FINRA responded to the comment letter.⁶ This order approves the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

⁴ See Securities Exchange Act Release No. 59762 (April 14, 2009), 74 FR 18269 (“Notice”).

⁵ See letter from Clifford E. Kirsch and Eric A. Arnold for the Committee of Annuity Insurers, Sutherland Asbill & Brennan LLP, to Elizabeth M. Murphy, Secretary, Commission, dated May 12, 2009 (“CAI Comment Letter”).

⁶ See letter from Stan Macel, Assistant General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated June 1, 2009.

II. Description of the Proposal

NASD Rule 2820 prohibits members from participating in the offer or sale of variable life insurance and variable annuity contracts unless certain conditions are met (collectively, “variable contract”). Specifically, members: (i) may not participate in the offering or sale of a variable contract on any basis other than at a value to be determined following receipt of payment in accordance with the provisions of the contract, the prospectus and the Investment Company Act; (ii) must promptly transmit to the issuing insurance company all contract applications and at least the portion of the purchase payment required to be credited to the contract; and (iii) requires selling agreements between principal underwriters of variable contracts and selling broker-dealers that provide that the sales commission will be returned to the issuer if the contract is rendered for redemption within seven business days after acceptance. Additionally, under NASD Rule 2820, members may not sell variable contracts unless the insurance company promptly honors customer redemption requests in accordance with the contract, its prospectus and the Investment Company Act.

Furthermore, NASD Rule 2820(g) prohibits associated persons of a member from accepting any compensation from any person other than the member with which the person is associated, in connection with the sale and distribution of variable contracts. However, there is an exception permitting arrangements where a non-member pays compensation directly to associated person, provided that the member agrees to the arrangement, and relies on appropriate rules or guidance from the Commission that apply to the specific fact situation of the arrangement, and the relevant associated persons treat the funds as compensation. Additionally, it prohibits associated person from accepting securities as compensation, limits the payment or receipt of non-cash compensation (such as gifts, entertainment, training or education meetings

and sales contests), and requires that certain records be kept. Currently, this provision requires a member to keep a record of all compensation received by the member or its associated persons from “offerors,” other than small gifts and entertainment permitted by the rule, and include the nature of, and “if known,” the value of any non-cash compensation received.

The proposed rule change would renumber NASD Rule 2820 as FINRA Rule 2320 in the Consolidated FINRA Rulebook and eliminate the phrase “if known” regarding the value of non-cash compensation. The deletion would require members to estimate the actual value of non-cash compensation for which a receipt (or similar documentation) assigning a value is not available and would be more consistent with the non-cash compensation recordkeeping requirements regarding public offerings of securities (FINRA Rule 5110(i)(2)) and direct participation programs (NASD Rule 2810(c)(2)).⁷ As stated in the Notice, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice.

III. Summary of Comments and FINRA’s Response

As previously noted, the Commission received one comment letter on the proposed rule change.⁸ While expressing general approval of the proposed rule change, the commenter expressed concern and sought clarification about the proposed change regarding the rule’s non-cash compensation provision. The commenter requested that FINRA confirm that it would respect a member’s reasonable estimate of the value of non-cash compensation. Specifically, the commenter asserted that, because the proposed “estimation” standard would be inherently imprecise, it would undoubtedly result in members valuing similar forms of non-cash

⁷ FINRA has proposed to transfer NASD Rule 2810 without material change into the Consolidated FINRA Rulebook as FINRA Rule 2310. See SR-FINRA-2009-016.

⁸ See CAI Comment Letter, supra note 5

compensation differently. As such, the commenter requested that a member's estimate of value be respected, unless it is patently unreasonable.

In response, FINRA stated that members would be required to use good faith when estimating the value of non-cash compensation if a receipt or similar documentation is not available. FINRA acknowledged that, while there could be some differences regarding firms' estimates, FINRA believes that a good faith standard should help ensure that such differences are not significant, or can be distinguished based on underlying facts and circumstances. In addition, as stated in the Notice, the change would be consistent with the recordkeeping requirements for non-cash compensation received in connection with public offerings of securities⁹ and the offer or sale of direct participation programs.¹⁰

The commenter also requested no less than 180 days to implement the proposed rule change. It noted that members would need this amount of time to adopt new policies and procedures, modify or create computerized and/or other compensation tracking systems, notify and educate their registered representatives, and adjust their training programs to ensure compliance with the new requirements.

In response, FINRA stated that its general protocol is to announce the effective dates for new FINRA rules in Regulatory Notices that are published every other month. Each Regulatory Notice announces the effective dates of the new FINRA rules approved by the Commission during the preceding two months. The new FINRA rules' effective dates generally are sixty days

⁹ See FINRA Rule 5110(i)(2).

¹⁰ See NASD Rule 2810(c)(2). See also note 7.

following publication of the relevant Regulatory Notice. Accordingly, FINRA would announce the effective date of the approved rule change, FINRA Rule 2320, in a Regulatory Notice to be published on or about August 17, 2009, which would establish an effective date for the rule on or about October 19, 2009. FINRA believes that an implementation period consistent with this general protocol would be adequate to implement the proposal, considering that the changes proposed are minor.

IV. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rule and regulations thereunder that are applicable to a national securities association,¹¹ and in particular, with Section 15A(b)(6) of the Act,¹² which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA's adoption of NASD 2820 with minor changes as FINRA Rule 2320 in the Consolidated FINRA Rulebook will continue the regulation of members in connection with the sale and distribution of variable contracts. Requiring members to assign a value for non-cash compensation based on a good faith estimate should make members' records more complete. The Commission also notes that a good faith standard should encourage reasonable estimates of the value of non-cash compensation. The Commission believes FINRA responded appropriately to the issues raised by the commenter.

¹¹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78q-3(b)(6).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-FINRA-2009-023) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Florence E. Harmon
Deputy Secretary

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).