

July 20, 2011

VIA E-MAIL

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

**Re: File No. SR-FINRA-2011-028  
Notice of Filing of Proposed Rule Change to Adopt Rules Regarding  
Supervision in the Consolidated FINRA Rulebook**

Dear Ms. Murphy:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),<sup>1</sup> in response to the *Notice of Filing of Proposed Rule Change to Adopt Rules Regarding Supervision in the Consolidated FINRA Rulebook* ("Proposal Notice") issued by the U.S. Securities and Exchange Commission (the "SEC") on June 23, 2011.<sup>2</sup> The Proposal Notice solicits comment on rule changes (the "Proposed Rule Change(s)") to, among others, NASD Rule 3010 (the supervision rule) and NASD Rule 3012 (the supervisory controls rule) proposed by the Financial Industry Regulatory Authority ("FINRA") as part of the FINRA Consolidated Rulebook. The Proposal Notice would adopt Proposed FINRA Rule 3110 to replace NASD Rule 3010, and Proposed FINRA Rule 3120 to replace NASD Rule 3012.

**Overview of Proposed Rule Changes.** The Proposal Notice sets forth the Proposed Rule Changes that were first exposed to member firms by FINRA via a 2008 Regulatory Notice.<sup>3</sup> The NASD Rules impacted under RN 08-24 (the "2008 Proposal") were among the very first

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<sup>1</sup> The Committee of Annuity Insurers is a coalition of 31 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 80 % of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

<sup>2</sup> The Proposal Notice was published in SEC Release No. 34-64736, 76 Fed. Reg. 38245 (June 29, 2011).

<sup>3</sup> Regulatory Notice 08-24 (May 2008) ("RN 08-24").  
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rules subject to revision under FINRA's rulebook consolidation project. The Proposed Rule Changes address a very wide array of provisions that establish the fundamental supervisory obligations of member firms with respect to their securities and non-securities business, and also includes proposed new "stand alone" rules to address holding customer mail and firms required to engage in "taping" activities.

### COMMITTEE COMMENTS

The Committee believes that a number of aspects of the Proposed Rule Changes provide welcome changes to the existing requirements. In particular, the complex NASD Rule 3012 requirements to review producing manager business have been greatly simplified. In addition, the Committee commends FINRA on SM.07 of Proposed FINRA Rule 3110 that provides latitude for member firms to rely upon risk-based transaction review principles. However, there are a number of aspects of the Proposed Rule Changes upon which the Committee provides more detailed comments below.

#### REGULATION OF NON-SECURITIES BUSINESS OF MEMBER FIRMS

**Proposal.** Under the 2008 Proposal, FINRA had proposed that member firms would be required to assign a duly registered and qualified principal to supervise each area of a member firm's business, regardless of whether such line of business required a firm to be registered. In its 2008 letter on RN 08-24, the Committee was one of many commenters that opposed that proposal.<sup>4</sup> The Committee is pleased to see that the Proposed Rule Changes do not include that provision. The Committee notes that FINRA has, in the Proposal Notice, and in SM.01 to Proposed FINRA Rule 3110 ("SM.01"), set forth its view of the supervisory obligations of member firms with respect to a firm's business lines, which could include non-securities business. As stated in the Proposal Notice, FINRA believes that FINRA Rule 2010, the just and equitable principles of trade requirement, among other things, imposes an obligation on member firms to supervise all of their business lines, not just their securities business.

**Comment.** The Committee appreciates the revisions made to Proposed FINRA Rule 3110 eliminating the requirement to assign a registered principal to supervise each non-securities line of business. In addition, the Committee believes that FINRA's explanation of the manner in which a member firm should be required to supervise its non-securities business is helpful to some degree. However, the Committee would request that FINRA clarify or consider three other issues associated with the supervision of non-securities business by member firms. First, the Committee believes that it is important for FINRA to acknowledge that outside business activities of registered persons are not subject to SM.01 and firm supervision obligations under Proposed FINRA Rule 3110. These outside business activities would, of course, be subject to

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<sup>4</sup> See Committee Comment Letter dated June 13, 2008. ("2008 Committee Comment Letter").  
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FINRA Rule 3270 obligations which the Committee views as establishing a set of obligations on firms that is different from those under Proposed FINRA Rule 3110. Second, the Committee believes that the obligation of a member firm to supervise its non-securities activities should not in any way be deemed to provide FINRA with additional jurisdiction over member firm affiliates that might also be engaged in the non-securities activities. For example, if a member firm is engaging in the sale of fixed annuities of its affiliated insurance company, the firm's oversight obligations of its fixed annuity sales activities required under SM.01 should not be viewed as permitting FINRA to oversee, supervise, or request documentation from the firm's affiliated insurance company. Third, the Committee would be very concerned with any FINRA practice, either under SM.01 or the yet to be proposed private securities transaction rule, or the interplay of those rules, that would permit FINRA to effectively enforce and oversee the investment advisory regulatory regime with respect to (1) a member firm that is dually registered as an investment adviser, or (2) its personnel that are engaged in investment advisory activities either as investment adviser representatives of the dually registered firm or through unaffiliated investment advisory firms. The Committee believes that FINRA must interpret SM.01 in a manner that clearly indicates that it is not substantively enforcing other regulatory regimes (e.g., state insurance laws, the Investment Advisers Act of 1940),<sup>5</sup> and that it is focused only on the firm's oversight and supervision of the non-broker-dealer activities, and not its substantive, technical compliance with non-broker-dealer regulatory requirements.

## **SUPERVISION OF SUPERVISORS**

**Proposal.** Under Proposed FINRA Rule 3110(b)(6)(C), FINRA proposes a new requirement with respect to member firm procedures related to the appropriate chain of supervision. As described by FINRA, the new rule proposal is designed to address "potential abuses in connection with the supervision of supervisors."<sup>6</sup> In addition, FINRA indicates that this provision would, in effect, replace the provisions under NASD Rule 3012(a)(2) related to the review and supervision of a producing manager's business.

Under the terms of Proposed FINRA Rule 3110(b)(6)(C), a member firm must have procedures in place to "prohibit" supervisors from:

- Supervising their own activities; and
- Reporting to, or having their compensation or continued employment determined by, a person or persons they are supervising.

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<sup>5</sup> As discussed in the 2008 Committee Comment Letter, the Committee believes that substantive oversight of non-broker-dealer activities could lead to conflicting interpretations from different regulators. In addition, FINRA staff would need to become subject matter experts on non-broker-dealer related matters.

<sup>6</sup> 76 Fed. Reg. at 38248.

For ease of reference, these restricted supervisory structures are referred to herein as “Restricted Supervisory Structures.” If a firm determines that it will utilize a Restricted Supervisory Structure, under Proposed FINRA Rule 3110(b)(6)(C) the firm must document the factors used by the firm to make that determination, and how the proposed supervisory arrangement meets the general requirements under Proposed FINRA Rule 3110(a).<sup>7</sup>

FINRA includes SM.12 to Proposed FINRA Rule 3110 (“SM.12”) which indicates that an exception to the Restricted Supervisory Structure “generally will arise only in instances where” the member is a sole proprietor in a single person firm, or the supervised person is the, or one of the most senior, executive officers of the firm.

**Comment.** The Committee commends FINRA on the proposal to remove the complex requirements under NASD Rule 3012 with respect to the review and supervision of producing manager business. The Committee believes that a principles-based approach for such activity is preferable to the approach under NASD Rule 3012.

The Committee does have several comments with respect to the terms of Proposed FINRA Rule 3110(b)(6)(C). The Committee believes that there is some tension between the proposed documentation standards, and SM.12 identifying those situations which generally will be the only exceptions to the Restricted Supervisory Structure. The Committee believes that, if the exception falls within one of the SM.12 exceptions, it stands to reason that a member firm should not be required to produce any significant documentation related to that determination.

Furthermore, the Committee believes that SM.12 exceptions do not recognize the potentially limitless number of situations, some of them somewhat commonplace among particular types of firms, that may also merit an exception. By simply identifying the two most obvious examples and identifying them in the SM.12 exception, FINRA has effectively created a presumption that any other type of determination by a firm to provide an exception to the Restricted Supervisory Structure is possibly untenable. The Committee recommends that FINRA convert SM.12 to be drafted in the form of providing illustrative examples of when the exception would likely apply, rather than in a manner that creates a negative presumption on all the other myriad supervision relationships that might be appropriate to serve as exceptions to the Restricted Supervisory Structure.

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<sup>7</sup> Presumably, this refers to the requirement for member firms to establish a system of supervision that is “reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA and Municipal Securities Rulemaking Board (MSRB) Rules.”  
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## OFFICE INSPECTIONS

**Proposal.** Proposed FINRA Rule 3110(c) sets forth certain requirements for a firm's office inspection program. In particular, Proposed FINRA Rule 3110(c)(3)(B) sets forth the following requirements on the persons conducting the inspection:

[T]he person conducting an inspection pursuant to paragraph (c)(1) is not an associated person assigned to the location or is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to the location.

**Comment.** The Committee requests that this provision be deleted in order to provide firms with more flexibility to design their own policies and procedures that serve to safeguard their inspections for conflicts of interest. In that regard, the Committee believes that FINRA could simply rely on the provisions of Proposed FINRA Rule 3110(c)(3)(A), which generally requires firms to have procedures designed to limit conflicts of interest in the inspections. Some firms have located personnel in offices who routinely conduct inspections and carry out supervisory responsibilities in the office. This provision could have the unintended effect of forcing firms to remove such valuable onsite personnel from the local offices. The Committee believes strongly that taking a more principles-based approach to the permitted identity of the personnel carrying out the office inspections would be beneficial to firms and investors.

In addition, the Committee further believes that the current prohibition may lead to particularly illogical and unwieldy results with respect to the inspection of home offices or administrative offices of a member firm. In many cases, the home office inspection team is likely to be located at the home office of the member firm. The Committee believes that FINRA should amend SM.16 to include associated persons located in a home office, or an administrative office, and conducting inspections of such offices, as an additional example of exceptions from the office inspection personnel restrictions.

## INSIDER TRADING

**Proposal.** Proposed FINRA Rule 3110(d) would require a member to include in its supervisory procedures a process for the review of securities transactions that are effected for the accounts of the member and/or the member's associated persons and their family members to identify trades that may violate the provisions of the Securities Exchange Act of 1934 ("Exchange Act"), the rules thereunder, or FINRA rules prohibiting insider trading and manipulative and deceptive devices. Proposed FINRA Rule 3110(d) would also require a firm to conduct promptly an internal investigation into any such trade to determine whether a violation of those laws or rules has occurred.

Pursuant to Proposed FINRA Rule 3110(d)(2), any member that engages in “investment banking services” would be required to provide reports to FINRA regarding such investigations. Proposed FINRA Rule 3110(d)(3)(B) defines the term “investment banking services” to include, without limitation: acting as an underwriter; participating in a selling group in an offering for the issuer, or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.

**Comments.** The Committee believes that the definition of “investment banking services,” as drafted and applied to the insider trading procedures is overly broad. The definition under Proposed FINRA Rule 3110(d)(3)(B) would seem to cover principal underwriters as well as selling firms with respect to variable annuities.<sup>8</sup> Since the rule seems to be focusing on a special class of firms that require additional measures to combat insider trading, it is not clear why it would be necessary, in furtherance of investor protection concerns, to deem principal underwriters of variable annuities, or routine selling firms as conducting “investment banking services.” The Committee believes that the definition of “investment banking services” should be revised to ensure that firms would not meet the definition as a result of serving as a principal underwriter or selling firm of such products.

The Committee also notes that the Proposal Notice appears to infer that firms may be required to, at a minimum, conduct periodic reviews of trading.<sup>9</sup> The Committee does not necessarily agree that would always be the case for all firm personnel in conducting a risk-based review as provided for under Proposed FINRA Rule 3110(d). Furthermore, the Committee is concerned that if such periodic review is required, implementing that new review process, particularly in light of the broad definition of “covered account,” would be a time consuming and burdensome process. As a result, the Committee request that a substantial implementation period be permitted with respect to the account reviews under Proposed FINRA Rule 3110.

The Committee further notes that the term “investment banking” is used in a number of places within FINRA rules and is not precisely defined throughout the FINRA rules. The Committee recommends that FINRA clarify that the term investment banking services as defined under Proposed FINRA Rule 3110(d)(3)(B) should only be viewed as applicable or informative with respect to Proposed FINRA Rule 3110.

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<sup>8</sup> While the Committee is commenting on the issues raised with respect to variable annuities, it appears to the Committee that the similar nature of other investment company products such as variable life insurance, mutual funds and 529 plans should be addressed in a similar manner.

<sup>9</sup> The Proposal Notice states: “[W]hile some members may need to develop restricted lists and/or watch lists, other members may only need to periodically review employee and proprietary trading.” 76 Fed. Reg. at 38259.  
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## **SUPERVISORY CONTROLS**

**Proposal.** Proposed FINRA Rule 3120 would replace NASD Rule 3012. Proposed FINRA Rule 3120(b) would require a member reporting \$150 million or more in gross revenue (total revenue less, if applicable, commodities revenue) on its FOCUS reports in the prior calendar year to prepare a report to senior management including the following items:

- a tabulation of the reports pertaining to customer complaints and internal investigations made to FINRA during the preceding year; and
- a discussion of the preceding year’s compliance efforts, including procedures and educational programs, in each of the following areas:
  - trading and market activities;
  - investment banking activities;
  - antifraud and sales practices;
  - finance and operations;
  - supervision;
  - anti-money laundering; and
  - risk management.

**Comments.** The Committee believes that Proposed FINRA Rule 3120(b)’s description of the items that would need to be included in the report to senior management is vague. The Committee is not entirely clear on what the scope and meaning of the requirement to include a “tabulation of reports pertaining to customer complaints and internal investigations made to FINRA” in the report to senior management. The Committee believes that further guidance with respect to this item would be beneficial (e.g., is it just FINRA Rule 4530 data for customer complaints? What are some examples of what would constitute a “report of . . . internal investigations made to FINRA”?). In addition, the Committee requests further clarification and guidance with respect to the items that would need to be included in this report, and in particular with respect to the items concerning “anti-fraud and sales practices,” “supervision,” “risk management,” and “trading and market activities.”

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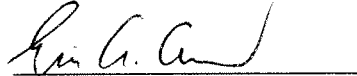
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The Committee appreciates this opportunity to comment on the Proposed Rule Changes. Please do not hesitate to contact Cliff Kirsch (212.389.5052) or Eric Arnold (202.383.0741) if you have any questions.

Respectfully submitted,

 Clifford Kirsch FAA

Clifford Kirsch

 Eric A. Arnold

Eric A. Arnold

## APPENDIX A

### THE COMMITTEE OF ANNUITY INSURERS

AEGON Group of Companies  
Allstate Financial  
AVIVA USA Corporation  
AXA Equitable Life Insurance Company  
Commonwealth Annuity and Life Insurance Company  
*(a Goldman Sachs company)*  
CNO Financial Group, 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)*  
SunAmerica Financial Group  
Sun Life Financial  
Symetra Financial  
The Phoenix Life Insurance Company  
TIAA-CREF  
USAA Life Insurance Company