

June 29, 2009

VIA ELECTRONIC MAIL

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

**Re: Regulatory Notice 09-25: Proposed Consolidated FINRA Rules  
Governing Suitability and Know-Your-Customer Obligations**

Dear Ms. Asquith:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),<sup>1</sup> in response to Regulatory Notice 09-25, "Proposed Consolidated FINRA Rules Governing Suitability and Know-Your-Customer Obligations" (the "Notice").

As described in the Notice, FINRA proposes to use NASD Conduct Rule 2310 as the model for FINRA Rule 2111 ("Rule 2111"), addressing the suitability obligations of member firms. In addition, the Notice indicates that FINRA proposes FINRA Rule 2090 ("Rule 2090") based on a modified version of NYSE Rule 405(1) that addresses know-your-customer ("KYC") obligations. Each of the proposed FINRA Rules makes modifications to the existing rules upon which they are based. The Committee appreciates the opportunity to provide comments on the proposed FINRA Rules.

**PROPOSED RULE 2111 – SUITABILITY**

As described in the Notice, Rule 2111 includes a number of changes to existing NASD Conduct Rule 2310, and also requests comments on certain specific aspects of the proposed

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<sup>1</sup> 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 the Committee's member companies is attached as Appendix A. 8454821.1

FINRA Rule. As set forth below, the Committee has comments on the following aspects of Rule 2111:

- (1) the proposed applicability of suitability obligations to “investment strategies” as well as securities;
- (2) the proposed expansion of a member firm’s duty to assess any recommendation in light of any information “known by the member or associated person;” and
- (3) the request for comment on expanding the suitability obligation to apply to any recommendation of the member firm, regardless of whether such recommendation is related to a security.

As a general matter, the Committee is concerned with any changes being made to the suitability obligations that are implemented in advance of clear resolution of certain regulatory reform efforts being seriously considered by Congress and the Obama Administration. For example, the Department of the Treasury’s report “Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation” (the “White Paper”) provides recommendations that could have a serious impact on the broker-dealer business. Under the White Paper, the Treasury Department recommends that broker-dealers providing investment advice should be subject to a fiduciary duty. The Committee is concerned that, depending on the timing of the possible rule changes, member firms could face **two** sets of significant rule changes impacting their review of customer transactions in rapid succession: FINRA changes to the suitability rules under Rule 2111; and large scale legislative changes to the standard of care owed by a broker-dealer under the recommendations of the White Paper. Each of these changes, on their own, would result in significant costs and expenditure of resources to member firms.

**Applicability of Rule 2111 to Recommendations of “Investment Strategies.”** Rule 2111 proposes to apply the suitability obligations to recommendations of “investment strategies” involving securities. The Notice indicates that this change “would codify longstanding SEC and FINRA decisions and other interpretations stating that NASD Conduct Rule 2310 covers both recommended securities and investment strategies.” The Committee notes that the Notice does not provide any citations to either SEC or FINRA decisions or interpretations, but does reference language that is present in the current Interpretive Material 2310-3 (“IM 2310-3”) covering institutional investors (i.e., the mere use of the term “strategy”). The Committee disagrees with the suggestion that the notion of “investment strategy” is well-embedded in IM 2310-3. In this regard, the Committee notes that IM 2310-3 identifies the suitability obligation with respect to a “strategy” in the second paragraph, but then never refers to that term again. In fact, the

remainder of IM 2310-3, in no less than three places, refers solely to transactions and not to strategies.<sup>2</sup>

The Committee has several concerns related to the proposed expansion of the suitability obligation to investment strategies involving securities. The Committee has fundamental concerns about the applicability by FINRA of a “suitability” obligation to anything other than a securities transaction. The suitability requirement historically has been rooted in a broker-dealer’s recommendation of a securities transaction, a discrete activity with clear boundaries. In contrast, FINRA’s use of the term “investment strategies” does not have clearly articulated boundaries.

Accordingly, if such a standard is adopted for recommendations of investment strategies involving securities, the Committee believes that significant additional guidance must be provided to define the parameters of what constitutes such an “investment strategy.” For example, would a dollar-cost-averaging feature in a variable annuity contract be an “investment strategy?”<sup>3</sup> Would an asset re-balancing feature in a variable annuity contract be an investment strategy? Would marketing material of an educational nature advising investors to save for retirement constitute an “investment strategy?” We would urge that such guidance be proposed for industry comment prior to the advancement of this aspect of the rulemaking.

The Committee also believes that member firms have significant experience and tools to use to evaluate, monitor and supervise suitability recommendations with respect to securities transactions. For example, many firms utilize exception reports to detect trends of securities recommendations based on the client’s age, income, net worth, etc. The manner in which a member firm would evaluate, monitor and supervise recommendations of “investment strategies” seems unclear. While firms have well-established practices, templates and screens to evaluate specific securities transactions, evaluating a general recommendation of an “investment strategy” involving securities is a very different task. It appears difficult to determine any meaningful way to evaluate whether a particular recommendation to engage in dollar-cost-averaging, for

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<sup>2</sup> IM 2310-3 refers to recommendations and suitability obligations without referring to “strategies” as follows:

(1) “While it is difficult to define in advance the scope of a member’s suitability obligation with respect to a specific institutional customer *transaction* recommended by a member . . .”;

(2) “Members are reminded that these factors are merely guidelines which will be utilized to determine whether a member firm has fulfilled its suitability obligation with respect to a specific institutional customer *transaction* . . .”;

(3) “Such a determination can only be made on a case-by-case basis taking into consideration all the facts and circumstances of a particular member/customer relationship, assessed in the context of a particular *transaction*.”

<sup>3</sup> Because the Committee’s focus is annuity-related issues, the examples we provide relate to common practices in the variable annuities marketplace. There are clearly many additional interpretive issues raised with other securities products offered by member firms relating to what constitutes an “investment strategy.”

example, was appropriate in a given fact situation, and it seems even less clear how a firm would supervise that aspect of the offer and sale of a variable annuity contract. In addition, the resources required to create the systems, workflow and documentation required to supervise recommended investment strategies in a comprehensive and systematic way would be substantial.

In sum, the Committee believes that the proposal to require a suitability review of recommended “investment strategies” involving securities should not be advanced because it is not consistent with the well-established broker-dealer regulatory framework with respect to suitability, which focuses on a broker-dealer’s recommendation of securities transactions. If FINRA determines to move forward with the proposal to include “investment strategies” in Rule 2111, the Committee urges FINRA to provide more guidance on: (1) what would be deemed to be an investment strategy in securities; (2) what type of suitability review process should be implemented for recommendations of investment strategies in securities; and (3) what type of monitoring and supervision might be appropriate to oversee recommendations of investment strategies in securities. Finally, the Committee believes that common features of a variable annuity contract such as dollar-cost-averaging and asset re-balancing should be excluded from the term “investment strategy.”

**Use of Information Known by the Member or an Associated Person.** Rule 2111 would expand the universe of information that must be considered by the member firm in making a recommendation to a customer. Under NASD Conduct Rule 2310, the member firm must assess only that information that is “disclosed by such customer,” and FINRA expands that requirement in Rule 2111 to require an assessment of such information and any “facts known by the member or associated person.”<sup>4</sup> The Committee is concerned that this requirement is overly broad and could lead to liability for firms for information that is not reasonably available to the firm. More importantly, the Committee believes that some of the objectivity of the suitability review process is lost, and less appropriate recommendations could be made, if representatives and firms are compelled to rely on “facts known by the member or associated person.” For example, based on certain non-objective criteria “known by” an associated person about a client (e.g., cars, jewelry, residence), the client could appear to be financially fit, while in reality such client could have a precarious financial position due to being heavily extended.

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<sup>4</sup> The Committee assumes that: (1) the term “associated person” as used under Rule 2111 would not be deemed to include any affiliated companies of the member firm consistent with the definition of that term under the NASD Bylaws; and (2) the proposal under Rule 2111 does not extend to the information of **any** associated person, but only the associated person who is making the recommendation. If those assumption are not accurate, the Committee believes Rule 2111 would be far too broad.

The Committee is also concerned about the member firm's possible responsibility to determine whether a client was a former client of the firm. If that is the case, is the firm required to review any available records related to that individual during their time as a former client in making the current suitability determination? In addition, the Committee is concerned about a registered representative who has a personal friendship or relationship with a client being compelled to use information obtained in the course of that relationship during the suitability assessment. For example, if a registered representative knows that a client engages in risky hobbies (e.g., mountain climbing, sky-diving) or has personal problems, do they need to consider that information in an assessment of whether a particular recommendation of a security is suitable? What is the appropriate way to assess such information? Do the "personal" factors identified above counsel towards recommending more conservative investments? The Committee believes that neither FINRA, nor member firms, should require representatives to make judgments based on such difficult to quantify personal criteria.

The Committee has further concerns about the manner in which such "facts known" would need to be documented, verified and maintained. Moreover, it would create significant burdens on firms if they would now be required to change their client recordkeeping structures to provide for an additional category of information – "facts known" about each client.

In sum, the Committee believes that imputing all the knowledge of the member firm and its associated persons to a particular client's suitability review does not necessarily improve the suitability review process, and is overly broad. The Committee recommends that Rule 2111 adopt the standard under NASD Conduct Rule 2310 of requiring members to assess only the information disclosed by the client. In the alternative, the Committee believes that if FINRA adopts the requirement to base recommendations on all facts known, there are several modifications that could address some of the critical issues raised above. For example, FINRA could: (1) provide that the requirement to assess any "facts known" in a suitability review is subject to some limited time horizon from which such facts are gleaned; (2) limit the information to be assessed to that related to the firm's, or associated person's, business relationship with the client with respect to the recommendation; and (3) provide guidance on, and limit the duties of the firm, with respect to information about former clients.

**Applying Rule 2111 to Non-Securities Product Recommendations.** The Notice requests comment on whether Rule 2111 should be applied to non-securities product recommendations. The Committee recommends strongly that Rule 2111 should not be applied to recommendations of non-securities products. The Committee believes that FINRA should focus on its primary charge of regulating the securities activities of member firms. FINRA has no experience or standards to apply in the context of non-securities product recommendations. In addition, the other products that might be recommended by a firm (e.g., fixed life insurance or annuity products, banking or lending products) will in many cases be subject to other robust state and/or federal regulatory regimes. Therefore, the potential for overlapping, redundant, or even

conflicting requirements is a significant concern to Committee members. The Committee believes that rules-based regulation of non-securities business activities would represent a dramatic departure from FINRA's regulation in the past, and potentially could be beyond the authorized scope of FINRA's mandate.

If FINRA determines that it has the authority to regulate the non-securities activities of its member firms and chooses to devote the resources to do so, the Committee recommends that FINRA take a more methodical and deliberative approach to ensure a thorough review of the impact and practicality of such non-securities regulation. The recent FINRA efforts to discuss these ideas in the context of isolated rule proposals<sup>5</sup> during the consolidated rulebook process appear to ignore the real import of such changes, and worse yet, could lead to fragmented and impractical requirements that both FINRA, and member firms, cannot review and oversee in an effective manner. The Committee believes that any initiative by FINRA to regulate the non-securities activities of a member firm should be undertaken, if at all, on a comprehensive basis that focuses on all the current rules and also explores what additional rules may be justified.

#### **PROPOSED FINRA RULE 2090 – KNOW YOUR CUSTOMER**

FINRA has proposed Rule 2090, modeled after NYSE Rule 405(1), to impose certain KYC obligations on FINRA firms. While Rule 2090 borrows heavily from Rule 405(1), it does impose an additional obligation on member firms to meet the standards of the rule "in regard to the . . . **maintenance** of every account" (emphasis added).

**KYC Obligations Are Duplicative of Other Existing and Proposed Rules.** As a preliminary matter, the Committee notes that the KYC obligations appear to be duplicative of a number of other requirements imposed under existing NASD and proposed FINRA rules. For example, there are requirements to verify the identity of the client (under NASD Rule 3011) and to keep certain client account information (under NASD Rule 3110); and proposed Rule 2111 would create an obligation to obtain certain customer-specific information. In addition, the SEC's rules related to broker-dealers impose requirements on firms with respect to maintaining and updating client information under Rule 17a-3(a)(17) of the Securities Exchange Act of 1934. The Committee believes that, at a minimum, FINRA should attempt to clarify how the information required to be reviewed and maintained for purposes of Rule 2090 differs from the requirements identified above. Moreover, the Committee suggests that FINRA reconsider whether Rule 2090, practically speaking, would provide any additional benefit to customers, or supervisory tools to members, beyond what currently is, or would be, provided under other rules.

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<sup>5</sup> See also Regulatory Notice 08-24 (proposing that member firms must assign a registered principal to be responsible for non-securities related business activities under the new FINRA rule focusing on supervision).  
8454821.1

**KYC During the “Maintenance” of an Account.** The Committee is concerned that the KYC obligations as revised provide an ongoing oversight requirement with respect to all customer accounts, regardless of the activity of the account. As with the proposal to assess suitability for “investment strategies,” the Committee believes that this standard is vague and, as such, would lead to inappropriate second-guessing by FINRA examiners. The Committee recommends that FINRA consider revising the rule to eliminate or limit the KYC obligations with respect to the maintenance of an account in a manner that is consistent with the historical obligations that have been imposed on a broker-dealer (e.g., account activity could trigger duties, but the mere passage of time, or status as a client, would not.)

If FINRA determines to require the KYC obligations on an ongoing basis, the Committee believes that FINRA should provide significant additional guidance. For example, FINRA should provide guidance on what an appropriate length of time might be to refresh a KYC determination and confirm the relevant essential facts. In the alternative, FINRA may want to provide guidance to members who want to develop a risk-based review by indicating what factors a member should consider in designing a KYC review schedule (e.g., customer profile, types of securities held, account activity).

**The Definition of “Essential Facts.”** The Committee believes that more guidance is necessary with respect to a firm’s obligation to know the “essential facts” related to a customer. While SM. 01 under proposed FINRA Rule 2090 indicates that firms must know the “financial profile” of the customer, that term is not defined.<sup>6</sup> The Committee recommends that FINRA provide additional guidance as to what might comprise a customer’s “financial profile.”

## CONCLUSION

The Committee appreciates the opportunity to comment on the Suitability and KYC obligations proposed under FINRA’s consolidated rulebook project. The Committee wishes to reiterate that it believes any efforts to expand FINRA’s oversight of the non-securities related activities of member firms should only be conducted in a comprehensive and deliberative manner that seeks to avoid any unintended consequences and allow for an integrated and complete consideration of the issues faced by both FINRA and member firms of any such proposals.

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<sup>6</sup> The Committee does not request any guidance on the terms “investment objectives or policy.”  
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Please do not hesitate to contact Cliff Kirsch (212.389.5055) or Eric Arnold  
(202.383.0741) if you have any questions.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: Clifford Kirsch ~~(DCA)~~

BY: Eric Arnold ~~(DCA)~~

FOR THE COMMITTEE OF ANNUITY INSURERS

## **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  
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