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April 18, 2014

VIA ELECTRONIC MAIL

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

Re: File No. SR-FINRA-2014-010
Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 2243
(Disclosure and Reporting Obligations Related to Recruitment Practices)

Dear Ms. Murphy:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),[1] in response to the *Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 2243 (Disclosure and Reporting Obligations Related to Recruitment Practices)* (the "Notice") issued by the U.S. Securities and Exchange Commission (the "SEC") on March 24, 2014. The Notice requests comments on a proposed rule change by the Financial Industry Regulatory Authority, Inc. ("FINRA") to adopt FINRA Rule 2243 (sometimes referred to herein as the "Proposed Rules"), which would establish disclosure and reporting obligations related to member firm recruitment practices.

COMMITTEE COMMENTS

The Committee appreciates the opportunity to comment on the Proposed Rules. By way of background, the Committee submitted a comment letter to FINRA in response to Regulatory Notice 13-02 ("RN 13-02") which initially proposed the recruitment compensation disclosure rules.[2] In the 2013 Comment Letter, the Committee expressed a number of criticisms of the rules, including that there were already FINRA rules in place to address the conflict concerns identified by FINRA from recruitment compensation, and that it was illogical and inefficient to

[1] The Committee was formed in 1982 to address legislative and regulatory issues relevant to the annuity industry and to participate in the development of securities, banking, and tax policies regarding annuities. For three decades, the Committee has played a prominent role in shaping government and regulatory policies with respect to annuities, working with and advocating before the SEC, CFTC, FINRA, IRS, Treasury, Department of Labor, as well as the NAIC and relevant Congressional committees. Today the Committee is a coalition of many of the largest and most prominent issuers of annuity contracts. The Committee's member companies represent more than 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

[2] A copy of the Committee's comment letter ("2013 Comment Letter") is available here: http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p220108.pdf.

move forward with a compensation disclosure obligation that focused solely on recruitment compensation concerns. The Committee did not find FINRA's response to the concerns raised in the 2013 Comment Letter (and by a number of other commenters) complete or persuasive. However, given that FINRA has advanced the Proposed Rules to their current status by filing them with the SEC, the Committee has determined that it is not worthwhile to restate our arguments with respect to the general merits of a rule requiring disclosure of recruiting compensation, but rather focus on a number of critical shortcomings under the Proposed Rules.

CONCERNS WITH THE PROPOSED RULES

The Committee has the following concerns with the Proposed Rules: (1) the Proposed Rules exert jurisdiction over the compensation practices of entities over which FINRA has no jurisdiction, including non-member insurance companies and investment advisers; (2) the required disclosures to "former customers"[3] will require customer-by-customer review to determine and tailor such disclosures appropriately and therefore will be unduly burdensome; (3) the proposed oral disclosure regime is unworkable in practice and extremely unlikely to provide any investor protection benefit especially during the early stages of a conversation between the registered person and the former customer; (4) the reporting requirements of the Proposed Rules should not advance until an opportunity is provided to better understand precisely what information must be collected, and how that information will need to be reported to FINRA; (5) FINRA should clarify certain issues related to the calculation of "potential future payments;" and (6) FINRA should consider and address the possible implications of the comprehensive customer disclosure obligations on standard non-solicitation covenants contained in the contracts between registered persons and their firms.

The Proposed Rules Exceed FINRA's Jurisdiction by Regulating the Compensation Disclosure Practices of Non-Member Companies

The Proposed Rules set forth a disclosure requirement for "upfront payments" and "potential future payments" made by a firm to its newly hired registered person. While the Proposed Rules, Supplementary Materials, and template recruitment disclosure form set forth much of the information about such disclosure, additional guidance is included in the Notice. In this regard, FINRA indicates that compensation received by a registered person from sources other than his or her broker-dealer may be viewed as recruiting compensation that should be counted toward the thresholds that require customer disclosure and FINRA reporting:

> FINRA understands that members sometimes partner with another financial services entity, such as an investment adviser or insurance company, to recruit a representative. In those circumstances, both upfront payments and potential future payments would include payments by the third party as part of the recruitment arrangement.[4]

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[3] Terms defined in the Proposed Rules are used in this comment letter with the same meaning.

[4] 79 Fed. Reg. 17,592, 17,594 (Mar. 28, 2014). The position is generally re-stated in a response to a commenter focusing on "dual hatted" registered persons at 79 Fed. Reg. at 17,608 ("the proposed rule change would require disclosure of recruitment compensation paid by non-member affiliates to the extent those amounts, when combined

FINRA has no authority to regulate the compensation practices of non-member insurance companies and their agents where such compensation is based on the sale of non-securities business. FINRA's proposed treatment of upfront payments or potential future payments from non-member companies has the potential to over-state the recruiting compensation attributable to securities brokerage activities of the registered person, and would in some cases count amounts that bear no reasonable relationship to the securities business of the registered person. The following examples illustrate the concerns with the proposed treatment of payments from affiliates under the Proposed Rules:[5]

> **Example 1:** Assume that a registered person who is a licensed insurance agent and a registered representative has historically produced 90 percent of his or her business production through fixed insurance products sales. Assume further that the insurance agent and registered representative is paid a $100,000 bonus by the insurance company for becoming a general agent of the insurance company and also becomes a registered person with the retail broker-dealer affiliate of the insurance company. Under the currently expressed position of FINRA, all of the $100,000 bonus would be treated as an upfront payment under the Proposed Rule.

> **Example 2:** Assume that a registered person who is a licensed insurance agent and a registered representative is recruited to become an agent of an insurance company and a registered person of such insurance company's affiliated broker-dealer. Assume further that the insurance company proposes to provide some potential future payments that are contingent on meeting certain fixed annuity sales goals. Under the Proposed Rules, FINRA would require: (1) an assumption that those sales goals were met; and (2) counting the fixed annuity compensation paid by the insurance company towards the $100,000 threshold for disclosing potential future payments under the Proposed Rules.

Especially given FINRA's intention to set a materiality threshold for the compensation disclosure requirement, the allocation of the amounts described in the examples above to the recruitment compensation of the registered person is illogical, unfair and in many cases could be misleading to an investor. Moreover, the Committee believes that the attempt to control the compensation paid under regulatory regimes by entities that are not subject to FINRA's jurisdiction, and to require disclosure thereof, is over-reaching and may well be unenforceable if adopted. The Committee does recognize that FINRA may be concerned that the recruiting compensation paid by an affiliate of the broker-dealer may be more logically attributed to the broker-dealer. The proposal by FINRA to address that concern, however, greatly over-reaches and needs to be better tailored to focus on the upfront payments and potential future payments

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with any recruitment compensation paid by the recruiting member, exceed the $100,000 thresholds for each category of recruitment compensation").

[5] The Committee notes that while these examples illustrate the issues created with respect to payments made by affiliated insurance companies, similar issues could arise with respect to payments from investment advisory affiliates.

that are reasonably attributable to the securities brokerage activities of the registered person.[6] The Committee believes that the Proposed Rules should not be approved with an interpretive position that effectively calls for FINRA regulation of the compensation practices of non-member firms. The Committee also notes that it is concerned that FINRA asserts such an expansive position in the Notice without reflecting the treatment of non-member compensation in the rule text or the accompanying disclosure template. For all of these reasons, this expansion into the regulation of non-member compensation should not advance.

The Required Customer Disclosures Create an Unnecessary Burden to Tailor the Disclosures to Each Customer

Under the Proposed Rules a member firm is required, whenever there is an attempt to induce a former customer to transfer assets to the registered person's new firm, to provide disclosure related to:

- the upfront and potential future payments made to such registered person;
- the costs that will be incurred by the former customer related to terminating the old account or opening the new account; and
- the portability of the assets held in the account to be transferred and the implications (e.g., costs, taxes) to the former customer.

The Committee believes that the provisions related to the required disclosures should be revised in a manner that allows for generalized disclosure for each former customer. As drafted, the Proposed Rules would require a detailed and burdensome review of: (1) all fees and charges associated with the old and proposed new accounts to determine whether or not such fees might trigger disclosure; and (2) all assets held through the previous firm and whether such assets are capable of being transferred to, and serviced by, the new firm. The Committee notes that the Notice repeatedly indicates that the disclosures related to compensation and the account transfer process are intended to open a dialogue between the registered person and his customer about the account transfer process.[7] The Committee believes that more general disclosure relating to the compensation, costs and portability would meet FINRA's objectives more efficiently and effectively than the current proposal, without jeopardizing customer protection.

More specifically, the requirement to disclose compensation in the five compensation ranges should be eliminated and instead the compensation disclosure should simply be required if such compensation exceeds $100,000. In the Notice, FINRA indicates that the proposed ranges of compensation disclosure will "provide customers with meaningful information, *i.e.*, that compensation may have been a motivating factor in their representative's decision to change firms."[8] The Committee believes strongly that simply disclosing that the amount of recruitment

[6] As described below with respect to the FINRA reporting obligations under Rule 2243(c), the Committee believes that moving the Proposed Rules immediately to the SEC without additional time for public comment on significant, new provisions of a proposed new rule creates a problematic rulemaking environment in which the rules are rushed through without careful consideration and vetting by all interested parties.

[7] 79 Fed. Reg. at 17595, 17,605.

[8] *Id.* at 17,597.

compensation exceeds $100,000 will be sufficient to put the former customer on notice that the registered person's movement to the new firm may have been financially motivated.

It is critical that FINRA recognize the potential undue burden of the Proposed Rules and consider whether less burdensome alternatives are available. The Committee believes this would be consistent with the framework FINRA announced in September 2013 for conducting an economic impact assessment of proposed new rules, including attempting to minimize burdens.[9] More specifically, the Framework Report indicates that "[a]s a matter of practice, FINRA's goal is to design its proposed rules to most efficiently achieve the intended regulatory benefit."[10] The Committee believes that the Proposed Rules could provide equal benefit to investors by "opening the dialogue" between the registered persons and their former customers with factual information about the recruitment compensation and the impact of the proposed transfer of assets to the new firm without requiring the firm to complete an individualized assessment of the impact on each customer.

The Oral Disclosure Requirements Are Unworkable and Will Confuse Investors

Under the Proposed Rules, a firm and its registered persons are required to provide the disclosures orally at the time of the first individualized contact. As indicated in the Notice, FINRA is taking a very broad view of what would constitute the first contact and an attempt to induce a customer to move his or her account to the new firm:

> Under the proposed rule, FINRA would consider a phone call to a former customer announcing a representative's new position with the member to qualify as first individualized contact and an attempt to induce the former customer to transfer assets to the member even when the conversation is limited to an announcement. Therefore, the proposed disclosures must be provided orally during the phone call and must be followed by written disclosures sent within 10 business days from such oral contact or with the account transfer approval documentation, whichever is earlier.[11]

FINRA's illustration of the type of contact that would trigger an oral disclosure obligation provides the perfect example of the burden, lack of efficiency, and ineffectiveness of an oral disclosure obligation. This becomes readily apparent when one visualizes the efforts of the registered person attempting to explain all of the content included on FINRA's template disclosure form over the phone on a "catching up" call with a former customer, including but not limited to the following:

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[9] *See Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking* (Sept. 2013) (the "Framework Report").

[10] *Id.* at p. 3. Moreover, while FINRA states in the Notice that it does not intend to discourage registered representatives transferring to new firms, it has presented no concrete assessment of how the new disclosure regime under the Proposed Rules may impact the mobility of registered persons, which could have a negative impact on competition. *See* 79 Fed. Reg. at 17,602.

[11] 79 Fed. Reg. at 17,605.

- Describing the amount of upfront payments, whether such payments are asset-based or production-based or based on some other factor;
- Describing the definition of "upfront payments" (e.g., cash, deferred cash bonus, forgivable loans, loan bonus agreements, transition assistance, equity awards);
- Describing the definition of potential future payments, and potentially how they are calculated;
- Describing the costs to transfer assets; and
- Describing the issues related to portability of assets.

Clearly, the effectiveness of that disclosure is going to be limited. In all likelihood, the only way to meet the obligations imposed under the Proposed Rule will be for firms to require the registered person to read the entire template disclosure form (and any qualifiers and modifications). The amount of time it would take a registered person to provide that information orally would lose the attention, and probably confuse, even the most detail-oriented and intelligent investor. The Committee believes strongly that the oral disclosure requirement should be eliminated. The proposed oral disclosure obligation would also pose significant documentation and review issues for both firms and FINRA staff. If the oral disclosure obligation under the Proposed Rules is not eliminated, the Committee believes that the quantity of content that is required to be provided through oral disclosure should be substantially narrowed down from the content required under written disclosures.

The FINRA Reporting Requirement

Under the Proposed Rules, member firms would be required to report to FINRA at the beginning of the employment of a registered person if they anticipate that the annual compensation of the registered person will increase by the greater of 25 percent or $100,000. The report to FINRA will "include the amount and form of such total compensation and other related information, in the time and manner that FINRA may prescribe."[12] The Committee finds it difficult to provide specific comments on this provision given that there is little guidance to allow firms to fully comprehend the burden of collecting the required information and performing required calculations before making the report. In addition, the Committee believes that it would have greatly benefitted the rulemaking process if this element of the Proposed Rules was shared with FINRA members in advance of filing with the SEC. Finally, while the Committee is aware of FINRA's desire to acquire as many "datapoints" as possible about a firm's securities business and a customer's securities holdings to assist with its examination program, an appropriate balance must be struck between the potential value of those datapoints and the burdens imposed on firms and customers with respect to the collection of the information. The Committee believes that the reporting requirements of the Proposed Rules should not advance until an opportunity is provided to better understand precisely what information must be collected, and how that information will need to be reported to FINRA.

[12] Proposed Rule 2243(c).

Calculating Compensation Under the Proposed Rules

The Committee requests clarification on the calculation of the potential future payments. In particular, the Committee is unclear as to whether the potential future payments are designed to identify and aggregate amounts of compensation that might be payable to the registered person by the new firm over an unlimited time period. There does not appear to be any affirmative statement in the Notice or the Proposed Rules indicating that the calculation of potential future payments should be limited to any time period. (The Committee notes that there is guidance with respect to the calculation of the compensation under the FINRA reporting provision of the Proposed Rules that clearly focuses on the compensation amounts as being for annual amounts received by the registered representative.) The Committee urges that the Proposed Rules include reasonable time period limitations so that the possibility of receiving a small amount of potential future payments over a very long period does not distort the view of whether such compensation is sufficiently material so that customer disclosure should be required.[13]

Unintended Consequences of Comprehensive Disclosure Requirements to Former Customers

The Committee believes that FINRA should consider and address the possible implications of the comprehensive customer disclosure obligations on standard non-solicitation covenants contained in the contracts between registered persons and their firms. Courts generally have viewed announcements sent to former customers, without more, as permissible communications that do not violate non-solicitation covenants. Unless FINRA also makes clear that such general announcements do not constitute an "attempt to induce a former customer of that registered person to transfer assets," then the Proposed Rules could create a conflict between compliance with the generally acknowledged framework with respect to non-solicitation covenants and compliance with FINRA rules.

CONCLUSION

The Committee appreciates the opportunity to comment on the Proposed Rules. Please do not hesitate to contact Eric Arnold ([redacted]) or Cliff Kirsch ([redacted] if you have any questions regarding this letter.

[13] As with the changes to the Proposed Rules related to FINRA reporting obligations and the implications of recruitment compensation paid by affiliated non-member companies, the Committee believes the calculation of potential future payments would have benefitted from an additional round of comments.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: _____
Eric Arnold

BY: _____ EAA
Cliff Kirsch

FOR THE COMMITTEE OF ANNUITY INSURERS

Appendix A

THE COMMITTEE OF ANNUITY INSURERS

AIG Life & Retirement
Allianz Life
Allstate Financial
Athene USA
AXA Equitable Life Insurance Company
Fidelity Investments Life Insurance Company
Genworth Financial
Global Atlantic Life and Annuity Companies
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
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
Symetra Financial Corporation
The Transamerica companies
TIAA-CREF
USAA Life Insurance Company
Voya Financial, Inc.