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January 20, 2016

VIA ELECTRONIC MAIL

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File Number SR-FINRA-2015-056
Notice of Filing of Proposal to Adopt FINRA Rule 2030 and FINRA Rule 4580 to Establish "Pay-to-Play" and Related Rules

Dear Mr. Errett:

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 SR-FINRA-2015-056 (the "***Notice***"), which was published in the Federal Register on December 30, 2015 by the Securities and Exchange Commission (the "***Commission***").[2] The Notice requests comments on FINRA's proposed "pay-to-play" rule, FINRA Rule 2030 ("***Rule 2030***") and FINRA Rule 4580 ("***Rule 4580***"). The Committee appreciates the opportunity to comment on proposed Rule 2030 and Rule 4580 (collectively, the "***Proposed Rules***").

[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 Commission, 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] 80 Fed. Reg. 81,650 (Dec. 30, 2015), which is available at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-30/pdf/2015-32894.pdf.

As explained in the Notice, the Proposed Rules respond to Rule 206(4)-5 ("***Rule 206(4)-5***" or the "***Adviser Rule***"), adopted by the Commission under the Investment Advisers Act of 1940, as amended (the "***Advisers Act***"), which among other things, prohibits an investment adviser and its "covered associates" from providing or agreeing to provide, directly or indirectly payment to a member firm to solicit a government entity on behalf of the investment adviser unless the member firm is subject to a FINRA pay-to-play rule.

The Committee supports FINRA's attempt to deter "pay to play" activity among "covered members" and agrees with many of the changes FINRA made to the Proposed Rules in response to comments received following publication of Regulatory Notice 14-50. However, the Committee remains concerned about certain provisions in the Proposed Rules. In this regard, the Committee's views are informed by its members' experiences in complying with Rule 206(4)-5. The Committee is particularly concerned about the application of the Proposed Rules to member firms selling variable annuities and other two-tiered investment products, and to traditional broker-dealer distribution activity.

In order to avoid unnecessary ambiguity and create a clearer rule that more closely tracks the Commission's goals regarding "pay to play" practices, the Committee asks that proposed Rule 2030 be further modified to: (i) clarify that the distribution of a two-tiered product such as a variable annuity is not solicitation activity for an investment adviser, consistent with existing law; (ii) clearly articulate the conduct that is prohibited; and (iii) provide guidance for compliance for two-tiered products such as variable annuities. In order to facilitate the staff's review of our comments, we intend to file suggested language in the next few days to supplement this letter.

I. Application of Proposed Rule 2030 to Variable Annuities

The Committee notes that the Proposed Rules and the Notice do not explicitly address the application of the Proposed Rules to variable annuities. The Committee seeks confirmation that Rule 2030 would not apply to variable annuities. The Committee notes that most of the variable annuities issued by its members are two-tiered products with the separate account registered as a unit investment trust ("***UIT SAs***"). With these products the annuity contract is supported by a separate account that provides for investment among an array of specified mutual funds (in the case of registered separate accounts and some unregistered separate accounts relying on Section 3(c)(7) or 3(c)(11) of the Investment Company Act of 1940, as amended (the "***Company Act***")) or unregistered investment pools (often in the case of unregistered separate accounts relying on Section 3(c)(7) or 3(c)(11) of the Company Act). In UIT SAs, there are no investment advisory services provided at the separate account level, although there are investment advisers managing the underlying mutual funds or unregistered investment pools that are investment options under the annuity's sub-accounts.

The Committee contends that a covered member selling a variable annuity, particularly where the separate account is a UIT SA, cannot fairly be seen to be engaging in solicitation activities on behalf of all of the investment advisers and sub-advisers that manage the covered investment pools ("***CIPs***") available as investment options under the separate account and sub-accounts. The tenuous link between such investment advisers and the government entity in this case mandates this conclusion. The Committee thus urges the Commission to clarify that a covered member selling two-tiered investment products is not engaged in solicitation activities on behalf of the investment adviser and sub-advisers managing the funds available as investment options. While not as prevalent as UIT SAs, certain annuity contracts are supported by separate accounts that are themselves management investment companies. We would note that even in this structure, the link between any adviser to the management investment company and the government entity is tenuous.

With respect to UIT SAs, by way of example, where a variable annuity with a UIT SA is made available to a plan or program of government entity, such as a 457 plan, a broker-dealer will interact with the plan trustee to discuss the benefits and reasons for making the annuity available as an option on the plan. The trustee of the 457 plan may determine to make a variable annuity available and may determine which underlying investment options should be made available. However, no money is actually allocated to the underlying investment options (whether they are mutual funds or unregistered investment pools) as a result of the trustee's decision to make an annuity available as an investment option on the plan. It is the plan participants that decide whether to allocate funds to the variable annuity and the underlying investment options. As a result, certain underlying investment options may end up not having any funds allocated to them at all.[3]

Various member firms do not even discuss which investment options to make available with the plan trustee. In these instances, the decision is made solely by the trustee or in reliance on a separate third party consultant (unaffiliated with the member firm) that helps guide this decision. In these circumstances especially, applying Rule 2030 would serve no public interest since the member firm plays absolutely no role in discussing the investment options with the plan trustee.

While member firms may interact with the plan trustee and discuss which underlying investment options to make available they generally do not provide recommendations or other investment advice to plan participants. Instead, member firms generally have limited their interaction with plan participants to providing education. As a result, member firms do not have a role in determining or influencing how plan participants allocate their funds to the investment options. The investment advisory services provided at the underlying fund level are thus far removed from the member firm's interaction with the government entity at the separate account level.[4]

Given that many variable annuities have dozens of underlying investment options, many of which have multiple sub-advisers, if Rule 2030 were to apply to a member firm's sale of the annuity contract it would not be uncommon for a given variable annuity to result in a single member firm being deemed to solicit for over 60-70 investment advisers (including sub-advisers to the underlying investment options). The Committee submits that such a result is neither

[3] In addition, a given participant may decide to allocate all of their funds for the annuity to a general account option.

[4] It also is important to note that the value of a plan participant's allocation to a variable annuity is determined by the unit value struck at the separate account level. While this unit value is impacted by the performance of the underlying funds it is also impacted by a number of other unrelated factors. Accordingly, there is not a direct link between a plan participant's allocation to the underlying investment options and the value of the annuity.

intended nor required by the language in Rule 206(4)-7 and would make compliance with Rule 2030 impractical for broker-dealers selling variable annuities in the government market.

If the Commission determines that broker-dealers selling variable annuities constitute solicitation activities for purposes of Rule 2030 we request the Commission to consider and to provide guidance on the following questions: Is the selling broker-dealer deemed to be soliciting on behalf of the adviser of each of the underlying funds? Or only of advisers and sub-advisers of funds underlying investment options that are selected by contract holders? What about when an underlying fund is managed by an adviser that uses multiple sub-advisers? Is the selling firm deemed to be soliciting on behalf of all of the sub-advisers? How does the rule apply when a contract holder on his/her own allocates funds in the variable annuity to an option at a point of time (for example, five years) subsequent to the purchase of the variable annuity without any involvement of the selling firm? Such transactions typically are done directly with the insurance company – is the selling firm deemed to be soliciting on behalf of the adviser/sub-adviser of the funds underlying the sub-accounts that are selected by the contract holder (including any sub-advisers hired by the advisers of the underlying funds) at that point in time? In this respect, we note that the selling firm would not know of the contract holder's allocation – so how could it comply? More importantly, what public interest is furthered by applying the rule in this scenario? The Committee submits that the dynamics and structure of variable annuities, particularly those with UIT SAs, and the number of advisers and sub-advisers to the funds underlying sub-accounts makes compliance with proposed Rule 2030 impractical.

II. The Scope of Proposed Rule 2030

In its initial comment letter to FINRA the Committee asserted that paragraph (d) of proposed Rule 2030 appears to re-characterize ordinary distribution activities for CIPs as the solicitation of clients on behalf of the investment adviser to the CIP. The Committee is concerned that this paragraph will capture regular and customary broker-dealer distribution activities conducted by member firms for CIPs that do not implicate "pay-to-play" issues. The offer and sale of CIPs pursuant to a selling agreement or a placement agent agreement is a customary broker-dealer activity carried out by member firms. However, given the text of paragraph (d), it appears that member firms would be considered to be engaged in solicitation or distribution activities for purposes of the rule when the member offers and sells a CIP to a government entity.

The Committee believes that customary distribution activity by member firms for CIPs sold to government entities should <u>not</u> be treated as solicitation activity for an investment adviser for purposes of Rule 2030 simply because an investment adviser provides advisory services to a CIP that is available as an investment option in the variable annuity. In these circumstances, the investment adviser to the CIP is not seeking to provide and will not provide investment advisory services to the government entity purchasing interests in the CIP.

It is well established that the client of an investment adviser providing advisory services to a CIP is the vehicle itself, <u>not</u> the investors in the CIP. *See Goldstein v. Securities and Exchange Commission*, 451 F.3d 873 (D.C. Cir. 2006) (hereinafter, "***Goldstein***"). Proposed Rule 2030 would subject ordinary sales activity to the two-year time out in the rule should there happen to be a contribution made by a covered member or a covered associate to a government official. Given the continuous nature of many CIP offerings, the Proposed Rule 2030 will have a profound impact on member firms and would impose extensive costs on member firms seeking to comply with such requirement.

The Committee recognizes that, for purposes of paragraph (c) of Rule 206(4)-5, an investment adviser to a CIP in which a government entity invests is considered to provide investment advisory services directly to the government entity. However, it does not follow from this Advisers Act rule provision that a covered member selling interests in a CIP to a government entity should be deemed to be soliciting on behalf of the investment adviser directly. First, Advisers Act Rule 206(4)-5(c) concerns the relationship between an investment adviser and a government entity investor in a CIP managed by the adviser and in that respect disregards the fact that the investment adviser advises the CIP and not the government entity. In contrast, Rule 2030 concerns the relationship between the investment adviser and a covered member. The two rules thus concern different relationships; the language in Rule 206(4)-5(c) therefore does not lead to the policy underlying proposed Rule 2030(d).

Second, and more importantly, Rule 206(4)-5(c) did not seek to fundamentally re-characterize the activities engaged in by investment advisers. In contrast, proposed Rule 2030(d) would recast traditional broker-dealer activity (the offer and sale of CIP securities pursuant to a selling or placement agent agreement) into something it is not: the solicitation of investment advisory services on behalf of an investment adviser. This re-characterization is contrary to the distinction drawn by the Commission staff between solicitation activities for investment advisers and distribution activities for pooled investment vehicles.

More particularly, for purposes of Rule 206(4)-3 under the Advisers Act, which applies to solicitation activities on behalf of investment advisers, the Commission staff has stated that "[w]e believe that Rule 206(4)-3 generally does not apply to a registered investment adviser's cash payment to a person solely to compensate that person for soliciting investors or prospective investors for, or referring investors or prospective investors to, an investment pool managed by the adviser." The staff elaborated that:

> While the Rule literally could apply to such payments, we believe that the Commission did not intend for the Rule to apply to those payments, for a number of reasons. First, neither the Proposing Release nor the Adopting Release contains any statement directly or indirectly suggesting that the Rule would apply to investment advisers' cash payments to others solely to compensate them for soliciting investors for investment pools managed by the advisers. While not dispositive of the issue, we believe that the absence of any such statements by the Commission suggests that it did not intend that the Rule should apply to such payments. Second, the Rule is designed so as to clearly apply to solicitations and referrals in which the solicited or referred persons might ultimately enter into investment advisory contracts with the investment adviser, yet investors in investment pools (as such) do not typically enter into investment advisory contracts with the investment advisers of the pools. Third, the Rule's use of the terms "client" and "prospective client," rather than "investor" or "prospective investor," also strongly suggests that the Rule was intended to apply to solicitations and referrals in which the solicited or referred persons might ultimately enter into investment advisory contracts with the investment adviser.

> Furthermore, the *Goldstein* decision supports the conclusion that the Rule generally does not apply to advisers' cash payments to others solely to compensate them for soliciting investors to invest in investment pools managed by the advisers. In *Goldstein*, the court indicated that, for purposes of Section 206 of the Advisers Act, investors in a pooled investment vehicle are not "clients" of the investment adviser of the pool. Similarly, we believe that the references to "client" and "prospective client" in Rule 206(4)-3 under the Advisers Act should not be interpreted to include investors in investment pools or prospective investors in investment pools."
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> For example, the Rule would not appear to apply to a registered adviser's cash payment to a person for referring other persons to the adviser where the adviser manages only investment pools and is not seeking to enter into investment advisory relationships with other persons, and the adviser's cash payment, under the adviser's arrangement with the referring person, compensates the referring person solely for referring the other persons to the adviser as investors or as prospective investors in one or more of the investment pools managed by the adviser.[5]

Proposed Rule 2030(d) thus would put selling firms in a contradictory position under FINRA rules and Advisers Act rules. Sales of CIPs do not subject them to the provisions of the cash solicitation rule provisions of Rule 206(4)-3 under the Advisers Act because of the Commission staff's recognition that selling interests in a mutual fund or private fund does not entail soliciting on behalf of the investment adviser to the fund (since there is no investment advisory relationship formed or sought to be formed between investors in the fund and the adviser to the fund). In contrast, if proposed Rule 2030(d) were adopted as proposed, then a broker-dealer would be treated as though it were directly soliciting on behalf of an investment adviser to a CIP. In short, Proposed Rule 2030(d) seeks to create a relationship that the Commission staff has concluded does not exist.

We believe that the Second Circuit's decision in the *Goldstein* case and the Commission staff's interpretive position under Rule 206(4)-3 under the Advisers Act makes proposed Rule 2030(d) impractical. It would create significant confusion in the industry and undermine settled practices and understandings, while creating doubt as to the application of the *Goldstein* case and the Commission staff's guidance in the Mayer Brown no-action letter. In fact, proposed Rule 2030(d) would, to a large extent, *effectively* overturn the Second Circuit's decision in the *Goldstein* case and the Commission staff's interpretive guidance under Rule 206(4)-3; in order to comply with the rule's mandate, broker-dealers would be forced to recognize a relationship that is at odds with the holdings of the court decision and the no-action letter.

In addition, proposed Rule 2030(d) would take activity that FINRA, the Commission, the financial industry and the investing public have long-considered to be pure sales activity and recast it as something very different. Investment advisers do not generally view broker-dealers selling interests in variable annuities, mutual funds and private funds as soliciting an investment advisory relationship with investors who invest in these products (with whom they do not have

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[5] *Mayer Brown LLP* (pub. avail. July 28, 2008) ("***Mayer Brown***").

an investment advisory relationship). Likewise, broker-dealers do not view the offer and sale of variable annuities, mutual funds or private funds as soliciting an investment advisory relationship on behalf of an investment adviser with the investors when there will not be an investment advisory relationship between the investors buying the products and the investment advisers to the funds. Moreover, investors do not think that broker-dealers selling interests in the funds are soliciting an investment advisory relationship with the advisers to the funds they purchase. In short, proposed Rule 2030(d) seeks to create a paradigm that does not comport with the existing regulatory framework or the long-held views of regulators, broker-dealers, investment advisers or investors. The result will be considerable confusion within the industry and on the part of investors, including government entity investors.

The Committee is concerned that proposed Rule 2030(d) confuses broker-dealer activity and investment adviser activity. The Committee believes that the distribution of mutual fund shares provides a good example of the confusion created by proposed Rule 2030(d). The distribution of mutual fund shares is directly regulated by the Company Act. The Company Act contemplates that the distribution of mutual fund shares will be handled by a "principal underwriter" that enters into an agreement with the mutual fund. The Company Act also contemplates that the principal underwriter in turn may enter into selling agreements with other member firms for the distribution of fund shares. Significantly, the principal underwriter's agreement is with the fund, and not with the investment adviser to the fund. Indeed, the authority to offer and sell the fund's shares originates with the mutual fund, not with the investment adviser to the fund. Ordinarily, neither the principal underwriter nor the selling firm is in privity of contract with the investment adviser with respect to the distribution of fund shares. In other words, there typically is no contractual arrangement between the principal underwriter and selling firms, on the one hand, and the fund's investment adviser, on the other hand, covering the distribution of the fund shares. Given the absence of any such relationship, it is not clear how ordinary agreements for the distribution of fund shares can create the paradigm envisioned by proposed Rule 2030(d), that of the principal underwriter and selling firm "soliciting" on behalf of the fund's investment adviser simply because a government entity purchases mutual fund shares.

Stated alternatively, how can it be that a selling firm engaged in offering and selling a mutual fund pursuant to a selling agreement is deemed to be engaged in solicitation activity on behalf of an investment adviser with which it has no relationship? The foregoing question is particularly striking when one considers that the broker-dealer and investment adviser are different types of registrants engaged in different types of activity (distribution activity and discretionary asset management, respectively).

The Committee believes that a broker-dealer that offers and sells interests in a mutual fund or private fund cannot be characterized as soliciting on behalf of the investment adviser to a CIP. There is no basis for this notion given the Commission staff's interpretation in the Mayer Brown no-action letter and the *Goldstein* case discussed above, as well as the lack of any relationship between the selling firm and the investment adviser. It is contrary to the existing regulatory framework to characterize the offer and sale of a security in a fund as also involving a solicitation on behalf of an investment adviser. It is at odds with the fact that in selling a mutual fund a selling firm typically has no relationship with the investment adviser managing the fund. The relationship between a broker-dealer selling a variable annuity and the adviser to the CIP available as an investment option is even more attenuated in a variable annuity (particularly in the case of a variable annuity with a UIT SA).

III. Revise Rule 2030 to More Closely Track the Adviser Rule and Eliminate Unnecessary Ambiguity

We believe FINRA should revise Rule 2030 to more closely track the requirements of the Adviser Rule.

A. Rule 2030 Is Unnecessarily Ambiguous

Rule 2030(a) appears to borrow various elements from the Adviser Rule, including paragraph (c) governing CIPs[6] and paragraph (f)(9) defining "regulated person,"[7] in creating an unnecessarily ambiguous prohibition, as follows:

> No covered member shall engage in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution to an official of the government entity is made by the covered member or a covered associate (including a person who becomes a covered associate within two years after the contribution is made).[8]

It is unclear exactly what activities are prohibited by this provision, to whom it applies, and under what circumstances. Among other things, for example, it is unclear from a facial reading of Rule 2030(a) what distribution activities "with" a government entity would be prohibited, what compensation is covered by the Rule and who must pay it and when a member firm might be deemed to be acting "on behalf of" an investment adviser. When combined with the prohibition of Rule 2030(e) against doing indirectly what cannot be done directly, potential concerns over the Rule's ambiguity become even more acute. We are not alone in raising potential concerns regarding the ambiguity of Rule 2030.[9]

This ambiguity is of particular concern to life insurance companies that offer and sell variable annuities (and variable life insurance products) that are issued through UIT SAs. One potential concern, for example, is whether a member firm selling these products unknowingly

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[6] Rule 206(4)-5(c) states that "[f]or purposes of this section, an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity." (Emphasis added). Rule 2030 appears to borrow, among other things, the underscored language. Similar language also appears in Rule 206(4)-5(a)(2)(ii) pertaining to the prohibition on soliciting and coordinating contributions.

[7] Rule 206(4)-5(f)(9)(ii)(A) in effect requires FINRA to adopt pay-to-play rules that "prohibit members from engaging in distribution or solicitation activities if certain political contributions have been made" (emphasis added). Rule 2030 appears to borrow the underscored language.

[8] Rule 2030(a).

[9] *See, e.g.,* Notice at pp. 46-50 discussing inclusion of distribution activities.

might be deemed under Rule 2030 to be engaging in "distribution" activities "on behalf" of an investment adviser or sub-adviser to one or more CIPs that fund such products ("***underlying funds***") solely because it is offering to a government entity a variable product that includes sub-accounts that invest in such underlying funds. Potential concerns regarding the misapplication of Rule 2030 due to its ambiguity might arise in a variety of contexts, such as where a selling firm is affiliated with one but not all underlying fund advisers, and none of the sub-adviser(s) to any underlying funds, or none of the underlying fund advisers, but some of the sub-advisers.

B. The Adviser Rule Does Not Mandate the Use of the Term "Distribution"

In response to comments expressing concerns about the ambiguity of the references to "distribution" in Rule 2030, the Notice recites FINRA's belief that the Adviser Rule "requires FINRA to have a rule that prohibits member firms from engaging in distribution (as well as solicitation) activities if political contributions have been made."[10]

Respectfully, we note that while the Adviser Rule requires regulated persons to be subject to rules that prohibit them from engaging in certain "distribution or solicitation activities if certain political contributions have been made," the Adviser Rule does not mandate the use of the term "distribution" in describing the conduct prohibited by the Rule.

In this regard, we note that the Municipal Securities Rulemaking Board ("MSRB"), which has filed a proposed pay-to-play rule for municipal advisors,[11] is subject to the exact same provision in the Adviser Rule prohibiting "distribution or solicitation" activities, and yet nowhere does its proposed amendments to Rule G-37 (to expand the rule to cover municipal advisors) refer to "distribution." Even the proposed amendments relating to brokers, dealers and municipal securities dealers do not reference "distribution" activity. In addition, in extending the time for the ban on third party solicitation of advisory business from any government entity on behalf of an investment adviser, the Commission also made no mention of "distribution" activities by such third parties.[12]

Accordingly, we respectfully submit that rather than relying on disparate provisions of the Adviser Rule, which do not coordinate well, Rule 2030 could eliminate the ambiguity created

[10] Notice at 47 (emphasis added).

[11] Rule G-37 imposes a two-year timeout on brokers, dealers, or municipal securities dealers engaged in a municipal securities business with an issuer after a contribution to an official of such issuer is made by such persons, any municipal finance professional associated with such persons, or a political action committee controlled by such persons, with certain exceptions. Notably, the Adviser Rule was modeled after G-37. Political Contributions by Certain Investment Advisers, Advisers Act Release No. 3043 (July 1, 2010) (release adopting Rule 206(4)-5) ("***Adopting Release***") at 12 ("We modeled our proposed rule on those adopted by the Municipal Securities Rulemaking Board, or MSRB, which since 1994 has prohibited municipal securities dealers from participating in pay to play practices.") (citing to adoption by the Commission of MSRB Rule G-37 in 1994).

[12] Political Contributions by Certain Investment Advisers: Ban on Third-Party Solicitation; Notice of Compliance Date, Investment Advisers Act Release No. 4129 (June 15, 2015).

by the current proposed language by adapting the basic pay-to-play prohibition of the Adviser Rule to broker-dealers acting as third party solicitors.[13]

C. The Ambiguity of Rule 2030 Must Be Removed Because It Contravenes a Key Objective and Provision of the Adviser Rule

Rule 2030, by its repeated but largely unexplained use of the phrase "distribution or solicitation activities," and resulting ambiguous articulation of the basic prohibited conduct, contravenes one of the key animating principles of the Commission in crafting the Adviser Rule, which was to ensure that the rule is narrowly tailored to serve a compelling governmental interest, namely, the elimination of pay-to-play practices by investment advisers to prevent fraudulent acts and practices in the market for the provision of investment advisory services to government entities.

In adopting the Adviser Rule, the Commission demonstrated its sensitivity to, and careful consideration of, potential First Amendment concerns because of the Rule's potential impact on political contributions. Among other things, the Commission observed that "[l]imitations on contributions are permissible if justified by a sufficiently important government interest that is <u>closely drawn</u> to avoid unnecessary abridgment of protected rights."[14] To address these concerns, the Commission stated that it had "closely drawn rule 206(4)-5 to accomplish its goal of preventing quid pro quo arrangements while avoiding unnecessary burdens on the protected speech and associational rights of investment advisers and their covered employees. The rule is therefore closely drawn in terms of the conduct it prohibits, the persons who are subject to its restrictions, and the circumstances in which it is triggered."[15] Specifically, the Commission noted that the Adviser Rule applies to the subset of advisers "over which it has antifraud authority that we believe are <u>most likely</u> to be engaged by government clients to manage public assets either directly or through investment pools."[16]

Unlike the Adviser Rule, which prohibits specific conduct by investment advisers and certain of their covered associates,[17] we respectfully submit that Rule 2030 is not closely drawn in terms of the conduct it prohibits, the persons who are subject to its restrictions, and the circumstances in which it is triggered. Failing to meet this objective of the Adviser Rule would appear to be fatal to Rule 2030 inasmuch as the Adviser Rule requires the Commission to find,

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[13] Rule 206(4)-5(a)(2). *See* discussion in Section III.D., below.

[14] Adopting Release at 21 (emphasis added).

[15] *Id.* at 22 (emphasis added).

[16] *Id.* at 25 (emphasis added).

[17] The Adviser Rule prohibits (1) the provision of investment advisory services for compensation to government entities either directly or through CIPs within two years after a political contribution covered by the Rule has been made, and (2) the direct or indirect payment to any person to solicit a government entity for investment advisory services on behalf of such investment adviser other than a person who is a regulated person or an executive officer, general partner, managing member (or person with a similar status or function) or employee of the investment adviser.

by order, that Rule 2030 meets the objectives of the Adviser Rule.[18] Accordingly, we respectfully urge that Rule 2030 be amended to take into consideration the proposed revisions described below.

D. Proposed Revisions Would Eliminate Any Unnecessary Ambiguity While Fulfilling the Objectives of the Adviser Rule

Our proposed revisions to Rule 2030 which we intend to file with the staff in the next few days ("***proposed revisions***") would remove the word "distribution" except in describing the distribution of interests in CIPs managed by investment advisers, which is the only distribution-related activity that the Adviser Rule appears to expressly contemplate. The proposed revisions also would frame the basic prohibition of Rule 2030 in terms of the specific conduct by third party solicitors that is of concern in the Adviser Rule, namely, the solicitation by a covered member of a government entity for investment advisory services on behalf of an investment adviser that pays (or whose covered associate pays) the member, directly or indirectly, for such solicitation activity. The proposed revisions would eliminate the unnecessary ambiguity of Rule 2030 by more clearly specifying the conduct that would be prohibited if certain political contributions covered by the Rule were made. As a result, we respectfully submit that the proposed revisions would, among other things, eliminate the potential concern that a selling firm might violate Rule 2030 unknowingly due to being deemed to be acting on behalf of investment advisers or sub-advisers of underlying funds with which it has no relationship.

In addition, the proposed revisions would help Rule 2030 fulfill the objectives of the Adviser Rule by harmonizing the pay-to-play conduct prohibited by both rules. Whereas the Adviser Rule prohibits an investment adviser or its covered associates from making direct or indirect payments to third parties to solicit government entities for investment advisory services on behalf of such investment adviser if certain political contributions covered by the Adviser Rule have been made, the proposed revisions would mirror this prohibition by prohibiting a member firm from soliciting government entities for investment advisory services on behalf of an investment adviser that pays, or whose covered associates pay, the member firm for such solicitation if certain political contributions covered by the Rule 2030 have been made. The proposed revisions also would impose prohibitions on the distribution of interests in CIPs managed by such investment advisers that mirror the prohibitions of the Adviser Rule.

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[18] Rule 206(4)-5(f)(9)(ii)(B) requires that "[t]he Commission, by order, finds that such rules impose substantially equivalent or more stringent restrictions on broker-dealers than this section imposes on investment advisers and that such rules <u>are consistent with the objectives of this section</u>" (emphasis added). Recognizing that investment advisers might have difficulty monitoring the activities of third party solicitors, the Commission limited the universe of eligible solicitors to (1) certain associated persons of the adviser who would be subject to the Adviser Rule, and (2) regulated persons. The Adviser Rule defines "regulated persons" to mean broker-dealers and municipal securities advisors that are subject to pay-to-play rules issued by FINRA and MSRB, respectively, that prohibit them from "engaging in distribution or solicitation activities if certain political contributions have been made." Rule 206(4)-5(f)(9)(ii)(A). In each case, the Commission must find that the rules adopted by FINRA or the MSRB, as the case may be, not only impose substantially equivalent or more stringent restrictions on the broker-dealer or municipal advisor than the Adviser Rule imposes on investment advisers, but also are consistent with the objectives of the Adviser Rule.

At the same time, the proposed revisions would not result in any inappropriate narrowing of the scope of Rule 2030. To the contrary, the proposed revisions should help to facilitate compliance with the objectives of the Adviser Rule and with Rule 2030.

IV. Miscellaneous

A. Definition of Instrumentality

The Committee urges the Commission to clarify the meaning of "instrumentality" in the definition of "government entity." In this respect, the Committee notes that its members have struggled to understand the contours of this term in the context of the Adviser Rule. Without additional guidance, covered members will continue to struggle with whether a contribution to a given entity should be treated as a contribution to an "instrumentality" of a state or state agency, thus triggering the two-year time out period in Rule 2030. For example, member firms continue to wrestle with whether contributions to certain medical centers affiliated with a state university and certain utilities, foundations and transportation authorities are "instrumentalities." The Committee thus asks the Commission to provide additional guidance as to the criteria for determining whether an entity is an "instrumentality" under the Proposed Rules.

In response to the Committee's request FINRA wrote as follows:

> As stated in Regulatory Notice 14–50 and above, the definition of a ''government entity'' is consistent with the definition of that term in the SEC Pay-to-Play Rule. The SEC has not provided additional guidance regarding the meaning of the term ''instrumentality'' in connection with its Pay-to-Play Rule. Thus, at this time, FINRA declines to provide additional guidance as part of the proposed rule. FINRA recognizes, however, the concerns raised by CAI and will continue to discuss with the industry interpretive questions relating to the proposed rule change.

Since FINRA recognizes the issues raised by the Committee we ask the Commission to provide the requested guidance.

B. Prohibition on Soliciting and Coordinating Contributions

The Committee appreciates the statement by FINRA in the notice that "a direct contribution to a political party by a covered member of its covered associate would not violate the proposed rule unless the contribution was a means for the covered member to do indirectly what the rule would prohibit if done directly (for example, if the contribution was earmarked or known to be provided for the benefit of a particular government official)." FINRA notes that this guidance is consistent with guidance provided by the Commission in connection with the Adviser Rule. However, in footnote 41 of the Notice FINRA writes:

> Consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(9) defines the term ''payment'' to mean ''any gift, subscription, loan, advance or deposit of money or anything of value.'' This definition is similar to the definition of ''contribution,'' but is broader, in the sense that it does not include limitations on the purposes for which such money is given (e.g., it does not have to be made for

> the purpose of influencing an election). Consistent with the SEC Pay-to-Play Rule, FINRA is including the broader term ''payments,'' as opposed to ''contributions,'' to deter a covered member from circumventing the proposed rule's prohibitions by coordinating indirect contributions to government officials by making payments to political parties. See SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41043 n.331 and accompanying text (discussing a similar approach with respect to restrictions on soliciting and coordinating contributions and payments).

The Committee appreciates that the above language is based on guidance from the Commission in the Adviser Rule. The language from the body of the Notice indicates that a contribution to a political party by a covered member or its covered associate would not violate the Proposed Rules unless the contribution was a means for the covered member to do indirectly what the rule would prohibit if done directly. The Committee agrees with this statement and as FINRA notes, this conclusion is based on the "intent element" embedded in the definition of "contribution." However, as FINRA notes, the definition of "payment" is broader than the definition of contribution in that it does not have an "intent element." Given the language in footnote 41, members of the Committee have asked the following question: what value is provided by the quoted language regarding "contributions" given the language in footnote 41 regarding "payments"? Stated alternatively, is it the case that each and every "contribution" is, by definition, also a "payment" such that the language in footnote 41 "trumps" the language quoted in the body of the Notice and renders such language moot, with the result that soliciting a payment to a political party in the relevant jurisdiction is an automatic violation?

C. Proposed Rule 4580

The Committee continues to believe that not all payments to political parties or political action committees should have to be maintained; instead, only payments to political parties or political action committees where the covered member or a covered associate (i) directs the political party or political action committee to make a contribution to an official of a government entity which the covered member is soliciting on behalf of an investment adviser or (ii) knows that the political party or political action committee is going to make a contribution to an official of a government entity which the covered member is soliciting on behalf of an investment adviser, should have to be maintained.

FINRA responded to the Committee's comment by asserting that:

> . . . the proposed recordkeeping requirements are intended to allow FINRA to examine for compliance with its proposed pay-to-play rule. Thus, the reference to indirect contributions in proposed Rule 4580(a)(4) is intended to include records of contributions or payments a covered member solicits or coordinates another person or PAC to make under proposed Rule 2030(b) (Prohibition on Soliciting and Coordinating Contributions). In addition, payments to political parties or PACs can be a means for a covered member or covered associate to funnel contributions to a government official without directly contributing. Thus, FINRA is proposing to require a covered member to maintain a record of all payments to political parties or PACs as such records would assist FINRA in identifying

situations that might suggest an intent to circumvent the rule.

The Committee appreciates FINRA's rationale but believes the costs and burdens associated with the request far outweigh the benefits to FINRA in ensuring compliance with the rule and will lead to periodic "fishing expeditions" by FINRA examiners seeking member firms' explanations for a given payment to a political party of a state or political subdivision thereof.

D. Rule 2030's Exceptions

Proposed Rule 2030 would place substantial restrictions on the ability of covered members and their covered associates to make contributions to officials of government entities. The Committee believes that the proposed provisions are too restrictive in a number of respects:

- The proposed $350 and $150 *de minimis* exceptions are the same amounts adopted by the Commission in September 2010. These amounts, which fail to take inflation into consideration, are unreasonably low.
- The $350 amount under the proposed exception for returned contributions is unnecessary. There is no need to have a *de minimis* amount at all under this exception. If the contribution is returned as is required under the exception, then no harm will result as both the contributor and contributee are placed in the same position they would have been in had no contribution been made.

Proposed Rule 2030's limitations are not drawn with sufficient precision to match FINRA's interests in prohibiting pay-to-play activities while enabling member firms to continue to engage in solicitation activities on behalf of investment advisers for compensation, and would unnecessarily restrict the ability of covered members and their covered associates from contributing to candidates for government office. In order to avoid substantial limitations on the associational and expressive activities of covered members and their covered associates, the Committee urges that: the $350 and $150 amounts be raised substantially in the Adviser Rule and Rule 2030 and that the $350 amount under the proposed exception for returned contributions be eliminated in both rules.

V. CONCLUSION

As noted above, the Committee supports the regulatory objectives underlying the Proposed Rules and recognizes the challenges in crafting the Proposed Rules so that they reach all of the activity sought to be eliminated without also prohibiting activity that is harmless. This is a particularly difficult task in the context of a covered member that is part of a large financial complex where the activities of certain associated persons, affiliates or other related persons of the covered member may seem, on their face, to involve pay-to-play activity, but which, in fact, are completely harmless. The Committee hopes the Commission recognizes these challenges and the difficulties that language in the Proposed Rules presents for covered members that are part of such complexes. The Committee strongly believes that the broad and sweeping provisions of the Proposed Rules will result in confusion and uncertainty on the part of covered members as to what activity is permitted and a reduction in salutary business practices that superficially resemble pay-to-play activities.

The challenges presented by the Proposed Rules will be amplified if they were applied to the sale of two-tiered investment products, such as variable annuities. The Committee is concerned that FINRA did not adequately take account of the difficulties involved in applying the Proposed Rules to the sale of variable annuities or other two-tiered investment products. The Committee sees little benefit in extending the Proposed Rules to such activities. In this respect, the Committee believes that the offer and sales activity of member firms selling a variable annuity are too far removed from the investment advisory activities of the investment advisers to the funds underlying the contract for there to be a material benefit derived from extending the rules to such selling firm activity. The Committee also notes that the investment advisory services provided at the underlying fund level are far removed from the governmental entity deciding to make the variable annuity available as a plan option. Even if the Commission disagrees with the Committee and concludes that the Proposed Rules should apply to the sale of variable annuities and other two-tiered investment products, the Committee is confident that without specific guidance as to how the Proposed Rules apply in such contexts, the likelihood of uniform compliance by member firms is extremely low and the chance of disparate practices and confusion in the industry is very high.

The Committee appreciates the opportunity to submit comments in response to the Notice. Please do not hesitate to contact Cliff Kirsch [redacted], [redacted]) or Michael Koffler [redacted], [redacted]) if you have any questions regarding this letter.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: Cliff Kirsch / IJH
Cliff Kirsch

BY: Michael Koffler / IJH
Michael Koffler

FOR THE COMMITTEE OF ANNUITY INSURERS

Appendix A

THE COMMITTEE OF ANNUITY INSURERS

AIG Life & Retirement
Allianz Life
Allstate Financial
Ameriprise 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.