SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59772; File No. SR-FINRA-2008-019)

April 15, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment Nos. 1 and 2 and Order Granting Accelerated Approval to a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities

I. Introduction

On May 21, 2008, the Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act") [1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend certain provisions of NASD Rule 2821.[3] The proposed rule change would modify the rule's scope and the timing of principal review in addition to clarifying, through a "Supplementary Material" section following the rule text, various issues raised by commenters.[4] The proposed rule change was published for comment in the Federal Register on June 10, 2008.[5] The Commission

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 On March 17, 2008, FINRA filed a separate proposed rule change, which became effective upon filing, to delay the effective date of paragraphs (c) and (d) of NASD Rule 2821 until 180 days following the Commission's approval or rejection of the substantive proposed rule changes found in this filing. See Securities Exchange Act Release No. 57769 (May 2, 2008), 73 FR 26176 (May 8, 2008) (delaying order). Paragraphs (a), (b), and (e) of NASD Rule 2821 became effective as originally scheduled on May 5, 2008.

4 Id.

5 See Securities Exchange Act Release No. 57920 (June 4, 2008); 73 FR 32771 (June 10, 2008) ("notice" or "proposal").

received letters from 14 commenters in response to the proposed rule change.[6] On November 12, 2008, FINRA responded to the comments[7] and submitted Amendment No. 1 to the proposed rule change. On April 1, 2009, FINRA submitted Amendment No. 2 to the proposed rule change. This order provides notice of the proposed rule change, as modified by Amendment Nos. 1 and 2, and approves the proposed rule change, as amended, on an accelerated basis.

II. Description of the Proposed Rule Change

FINRA proposed to amend NASD Rule 2821 to modify the rule's scope and the timing of principal review. In addition, FINRA proposed to clarify various issues that commenters have raised through a "Supplementary Material" section following the rule text. These proposed changes are discussed in further detail below.

A. Limit Application of the Rule to Recommended Transactions

Paragraph (c) of NASD Rule 2821 requires principals to treat all transactions as if they have been recommended for purposes of the rule. Following the Commission's approval of the rule, however, several commenters asked that the Commission and FINRA reconsider this approach. As FINRA stated in the notice, some commenters asserted that applying the rule to non-recommended transactions would have unintended and harmful consequences. In particular, these commenters claimed that applying the rule to non-recommended transactions would effectively force out of the deferred variable annuities business some firms that offer low priced products, but that do not make recommendations or pay transaction-based compensation. In addition, commenters

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6 See infra note 9.

7 See Letter from James Wrona, Associate Vice President and Associate General Counsel, FINRA, to Florence Harmon, Acting Secretary, Commission, dated November 12, 2008 ("FINRA's Response").

stated that, absent a recommendation, a customer should be free to invest in a deferred variable annuity without interference or second guessing from a broker-dealer.

In response, FINRA proposed to limit the rule's application to recommended transactions. In the notice, FINRA explained that limiting the rule to recommended transactions would be consistent with the approach taken in its general suitability rule, Rule 2310. FINRA also stated that this change would not detract from the effectiveness of Rule 2821 because at firms that permit registered representatives to make recommendations concerning deferred variable annuities, the vast majority of purchases and exchanges of deferred variable annuities are recommended. FINRA offered further support for the rule change by stating that non-recommended transactions pose fewer concerns regarding conflicts of interest and less of a need for heightened sales-practice requirements. FINRA also indicated that this change would promote competition by allowing a wide variety of business models to exist, including those premised on keeping costs low by, in part, eliminating the need for a sales force and large numbers of principals. Finally, FINRA stated that attempts by registered representatives to mischaracterize transactions as non-recommended would be mitigated by the requirement that firms implement reasonable measures to detect and correct circumstances when brokers mischaracterize recommended transactions as non-recommended.

B. Modifying the Starting Point for the Seven-Business-Day Review Period

NASD Rule 2821(c) requires principal review and approval "[p]rior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application." A number of commenters have asserted that this seven-

day period may not allow for a thorough principal review. As mentioned in the notice, these commenters provided examples of situations where principal review might be delayed, such as when a customer inadvertently omits information from the application or when information provided by a customer on the application needs clarification.

FINRA proposed modifying the starting point for the seven-day review period. Under the proposal, the period would begin on the date when the firm's office of supervisory jurisdiction ("OSJ") receives a complete and correct copy of the application. FINRA stated that this approach would allow firms to resolve issues that result in foreseeable delays and to conduct a thorough review, while maintaining a definite period within which the principal must make a final decision.

To help ensure that the process remains efficient, the proposal would also require the associated person who recommended the annuity to promptly transmit the complete and correct application package to the OSJ. However, that provision, proposed paragraph (b)(3), would not preclude a customer who chooses to forward documents directly from transmitting the complete and correct application package to the OSJ.

C. Clarification of Issues through Supplementary Material

As indicated in the notice, previous commenters to the rule have raised a number of questions that FINRA believes require clarification. Accordingly, FINRA proposed adding a "Supplementary Material" section following the rule. FINRA also reconsidered the question of whether a member may forward funds to an insurance company for deposit in the insurance company's "suspense account" pending completion of principal review. In the notice, FINRA proposed modifying its earlier position rejecting such a process. Instead, FINRA proposed to allow the use of a "suspense account" under

limited circumstances, including, among other things, a requirement that the insurance company segregate the funds in a manner equivalent to that required of a member under Exchange Act Rule 15c3-3.[8]

The proposed Supplementary Material section also offered clarification in a number of areas, including the application of lump-sum payments where part of the payment is intended for a deferred variable annuity, forwarding customer checks, what constitutes a "reasonable effort" to determine whether a customer has had a recent exchange at another broker-dealer, and the permissibility of using information required for principal review in the contract issuance process. FINRA indicated that each of these issues could broadly impact how broker-dealers sell, or process transactions in, deferred variable annuities.

[8] 17 CFR 240.15c3-3.

III. Comment Letters

The Commission received letters from 14 commenters on the proposed rule change.[9] FINRA responded to the comments in a letter to the Commission.[10] The comments and FINRA's Response are discussed below.

A. Limiting Application of the Rule to Recommended Transactions

Several commenters supported FINRA's proposal to limit Rule 2821's application to "recommended" transactions,[11] generally indicating that the proposed change would:

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9 The Committee of Annuity Insurers ("CAI") submitted two separate letters that we consider to be one comment. See letter from Clifford Kirsch, Sutherland Asbill & Brennan LLP, on behalf of the CAI, dated July 1, 2008 ("CAI Letter") and from Clifford Kirsch, Sutherland Asbill & Brennan LLP, on behalf of CAI, dated December 19, 2008 ("CAI Letter II").

See letters from Deborah Peters, Director, Broker Dealer Compliance, EquiTrust Marketing Services, LLC to James Wrona, [Associate Vice President and Associate General Counsel, FINRA], dated June 11, 2008 ("EquiTrust Letter"); Darrell Braman, Vice President and Associate Legal Counsel and Sarah McCafferty, Vice President and Chief Compliance Officer, T. Rowe Price Investment Services, Inc., dated June 23, 2008 ("T. Rowe Price Letter"); Theodore Tsung, Financial Services Software Innovator – Founder of digiTRADE and EAssist, dated June 30, 2008; Laurence S. Schultz, President, Public Investors Arbitration Bar Association, dated June 26, 2008 ("PIABA Letter"); Teresa Luiz, GWFS Equities, Inc., dated June 30, 2008 ("GWFS Letter"); Heidi Stam, Managing Director and General Counsel, Vanguard, dated June 30, 2008 ("Vanguard Letter"); William A. Jacobson, Associate Clinical Professor, Cornell Law School, and Director, Cornell Securities Law Clinic, dated July 1, 2008 ("Cornell Letter"); Dale E. Brown, President and CEO, Financial Services Institute, dated July 1, 2008 ("FSI Letter"); Heather Traeger, Assistant Counsel, Investment Company Institute, dated July 1, 2008 ("ICI Letter"); Cheryl Tobin, Asst. Vice President, Insurance Counsel, Pacific Life Insurance Company to James Wrona, Associate Vice President and Associate General Counsel, FINRA, dated July 1, 2008 ("Pacific Life Letter"); Michael P. DeGeorge, General Counsel, NAVA, Inc., dated July 1, 2008 ("NAVA Letter"); Neal E. Nakagiri, President, CEO, CCO, NPB Financial Group, LLC, dated July 2, 2008 ("NPB Letter") and Carl B. Wilkerson, Vice President & Chief Counsel, American Council of Life Insurers, dated August 20, 2008 ("ACLI Letter"). Unless otherwise noted, all letters are addressed to the Secretary or Acting Secretary of the Commission.

10 FINRA's Response, supra note 7.

make the rule consistent with other rules that have a suitability requirement; promote competition; and not detract from the rule's effectiveness because most variable annuity transactions involve a recommendation. Two commenters, however, disagreed with the approach, arguing, among other things, that registered representatives could falsely assert that an unsuitable transaction was not recommended.[12] FINRA acknowledged the concern, but responded that it would be mitigated by the requirement that broker-dealers implement reasonable measures to detect and correct circumstances in which transactions can be mischaracterized.[13] In addition, FINRA stated that when a transaction is truly initiated by a customer, actual or potential conflicts of interest are less likely, and thus there is a lesser need for heightened sales-practice requirements.[14]

Another commenter requested clarification that a non-recommended transaction includes a direct sale (i.e., one in which no sales-related compensation is paid and no registered representative is involved).[15] FINRA responded that whether a transaction is recommended does not turn on whether it is a direct sale: some firms use an Internet-based computer system to make "recommendations" without assistance from a registered representative, while others compensate registered representatives for transactions solely initiated by the customer.[16] FINRA also reiterated several factors relevant to determining when a particular communication would be deemed a recommendation, including: a communication's content, context and presentation; the tailoring of the communication to

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11 See ACLI Letter, CAI Letter, ICI Letter, NAVA Letter, Vanguard Letter, T. Rowe Price Letter.

12 See Cornell Letter and PIABA Letter.

13 See FINRA's Response, supra note 7.

14 Id.

a certain customer or customers; and whether the communication was initiated by a person employed by the firm or by a computer program used by the firm.[17]

One commenter sought clarification of the rule's application to recommendations in the context of retirement plans.[18] FINRA's Response cited the rule's text, which states that the rule does not generally apply to transactions made in connection with specific employer-sponsored retirement plans except for recommendations made to an individual plan participant regarding a deferred variable annuity.[19] Furthermore, FINRA indicated that a member's "generic communication to all plan participants indicating that the employer has chosen a deferred variable annuity as the funding vehicle for its retirement plan likely would not constitute a 'recommendation' triggering application of the proposed rule."[20] Finally, FINRA reiterated that the rule would not apply to plan-level decisions made by sponsors, trustees, or custodians of qualified retirement or benefit plans, regardless of whether a member has made a recommendation to an individual plan participant.[21]

B. Modifying the Starting Point for the Seven-Business-Day Review Period

Most commenters supported FINRA's proposal to have the seven-business-day period for principal review of the application begin on the day that an OSJ receives the

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15 See Pacific Life Letter.

16 See FINRA's Response, supra note 7.

17 Id. (citing NASD Policy Statement Regarding Application of the NASD Suitability Rule to Online Communications, NASD Notice to Members 01-23 (April 2001)).

18 See GFWS Letter.

19 NASD Rule 2821(a)(1).

20 See FINRA's Response, supra note 7.

21 Id.

application.[22] One commenter expressed the view that the proposal gives the broker-dealer too much time and that the time period should start when any office receives the application.[23] Some commenters stated that the time period for review should be longer,[24] and some indicated that there should be an exception to the time limitations when a customer consents to a further holding period.[25] FINRA responded that they regard seven business days after receipt by any OSJ as sufficient time in which to review an application.[26]

C. Supplementary Material

1. Forwarding of customer checks/funds

Proposed SM.03 states that under certain conditions, a FINRA member may forward a customer's check or funds to the insurance company prior to principal approval.[27] One of those conditions is that the insurance company issuer agrees to "(1) segregate the member's customers' funds in a bank … account … (set up as described in [Exchange Act] Rules 15c3-3(k)(2)(i) and 15c3-3(f)) to ensure that the customers' funds will not be subject to any right, charge, security interest, lien, or claim of any kind in favor of the member, insurance company, or bank where the insurance company deposits such funds or any creditor thereof or person claiming through them and hold those funds

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22 See ACLI Letter, CAI Letter, FSI Letter, ICI Letter, NAVA Letter, NPB Letter.

23 See Pacific Life Letter.

24 See ACLI Letter, CAI Letter.

25 See ACLI Letter, CAI Letter, EquiTrust Letter, NAVA Letter.

26 See FINRA's Response, supra note 7.

27 NASD Rule 2821 initially prohibited broker-dealers from ever forwarding checks/funds prior to principal approval of the transaction. Most commenters to the original proposal favored allowing broker-dealers to forward checks/funds, but they differed regarding their views of FINRA's proposed requirements for allowing it.

either as cash or any instrument that a broker or dealer may deposit in its Special Reserve Account for the Exclusive Benefit of Customers . . . ."

The commenters on this provision generally viewed current insurer suspense account practices as sufficient but stated that the special account requirement would be feasible if modified.[28] For example, one commenter suggested that insurers be permitted to segregate funds in an account "similar in form and function to a Reserve Bank Account under [Exchange Act] Rule 15c3-3(e)."[29] This commenter also suggested that FINRA consider adopting exemptions from the SM.03 requirements depending on the treatment particular states afford to insurance company suspense accounts.[30]

FINRA's Response stated that during the period before the transaction is approved, when funds may need to be returned to the customer, it is important for a FINRA member to have reasonable assurances that the insurer will handle customer funds in a manner that provides at least as much protection as if those funds were handled by a broker-dealer that is permitted to hold customer funds.[31] Accordingly, FINRA declined to modify or eliminate the proposed requirements to maintain equivalent standards.[32]

In response to one commenter's question regarding whether the "Special Account Requirement" of SM.03 requires the segregation by the insurance company of customer

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28 See e.g., ACLI Letter, NAVA Letter, Pacific Life Letter, CAI Letter.

29 See CAI Letter. Exchange Act Rule 15c3-3(e) applies to broker-dealers that transmit funds promptly and that do not hold those funds for periods longer than one business day. 17 CFR 240.15c3-3(e).

30 See CAI Letter.

31 See FINRA's Response, supra note 7.

32 Id.

funds from one broker-dealer from those of other broker-dealers,[33] FINRA indicated that it does not.[34] FINRA's Response further stated that the insurer could use one special account for the customers of all the broker-dealers with which it does business.[35]

One commenter asked whether an insurance company could return customer checks/funds to the broker-dealer rather than directly to the customer if the broker-dealer's principal rejects the transaction.[36] FINRA responded that the insurance company may make checks payable to the broker-dealer if the broker-dealer is permitted to hold customer funds.[37] If broker-dealers that are not authorized to hold customer funds

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33 See NAVA Letter. NAVA also stated that, in its experience, "unaffiliated broker-dealers do not forward customer funds prior to principal approval." Id. In this regard, FINRA noted that SM.03 allows a broker-dealer to forward checks/funds under certain circumstances prior to principal approval; it does not require it. Moreover, the Commission's previous exemptive order allowing firms to hold checks for up to seven business days to complete the principal review applies under the proposed amendments. See FINRA's Response, supra note 7.

34 See FINRA's Response, supra note 7.

35 Id.

36 See CAI Letter.

37 See FINRA's Response, supra note 7. As FINRA and the Commission previously have noted, "Many broker-dealers are subject to lower net capital requirements under [Exchange Act] Rule 15c3-1 and are exempt from the requirement to establish and fund a customer reserve account under [Exchange Act] Rule 15c3-3 because they do not carry customer funds or securities." Securities Exchange Act Release No. 56376 (September 7, 2007), 72 FR 52400 (September 13, 2007). Although some of these firms receive checks from customers made payable to third parties, the Commission does not deem a firm to be carrying customer funds if it "promptly transmits" the checks to third parties. The Commission has interpreted "promptly transmits" to mean that "such transmission or delivery is made no later than noon of the next business day after receipt of such funds or securities." Id. In conjunction with its approval of NASD Rule 2821, the Commission provided an exemption to the "promptly transmits" requirement as long as, among other things, the "principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with [Rule 2821]." Id. The Commission's exemptive order remains applicable notwithstanding the modification to the event that triggers the principal review period. See discussion

receive checks from the insurance company, they should be payable to the customer. In those cases, FINRA stressed that broker-dealers must forward such checks to their customers "promptly" and keep an incoming and outgoing record of the customer checks, as well as any other funds that are remitted to the broker-dealer.[38]

Finally, one commenter expressed confusion regarding this provision, stating that "the insurance company would necessarily have a claim for payment if an application is approved and a contract issued, while the member would necessarily have a claim for a return of the funds if the application is not approved and the contract is not issued."[39] FINRA responded that it did not intend to suggest that the funds had to remain in a segregated bank account of the type referenced in SM.03 in perpetuity, but only until such time as the insurance company is notified of the broker-dealer's approval and is provided with the application, or is notified of the broker-dealer's rejection of the application.[40]

2. Inquiries about Exchanges

One commenter supported FINRA's proposal to clarify, in Rule 2821(b)(1)(B)(iii) and SM.05, that an analysis of whether the customer has had another recent exchange

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in Section III.B, supra of the amendment to rule 2821(c) establishing the timing for principal review.

38 See FINRA's Response, supra note 7.

39 See NAVA Letter.

40 See FINRA's Response, supra note 7. Under the rule as amended by Amendment No. 1, there could be delays between the time when a principal approves an application and the time when an insurer receives the approved application (e.g., when a broker-dealer conveys principal approval to the insurer electronically but sends an approved application via regular mail), thereby creating a situation where the funds in a suspense account are released before the insurance company has received the application. Amendment No. 2 clarifies that the insurance company must receive both a notification of approval and the application before funds can be released from the suspense account.

should include exchanges at other broker-dealers, but suggested that broker-dealers should be required to do more than simply ask the customer whether he or she has had another exchange. [41] The commenter explained that variable annuity transactions can be complex and confusing, and that some customers might not understand that they had engaged in previous exchanges.[42]

FINRA responded that requiring broker-dealers to investigate whether the customer has in fact had another exchange at another broker-dealer is overly burdensome in light of the potential benefits. FINRA indicated that instances of customer confusion regarding whether or not an exchange had occurred would likely be the exception rather than the rule. [43] FINRA further noted that SM.05 requires that a broker-dealer determine whether a customer has had another exchange at that firm and that, solely for exchanges that occurred at other firms, is permitted to rely on a customer's response to an inquiry regarding possible exchanges by the customer at other broker-dealers.[44] In addition, FINRA reiterated the SM.05 requirement that broker-dealers document in writing both the nature of the inquiry and the response from the customer.[45] FINRA stated that it believes that this requirement would help ensure that broker-dealers ask customers about exchanges in a manner that is reasonably calculated to elicit accurate responses.[46]

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41 See PIABA Letter. The rule currently states that the broker-dealer must consider whether "the customer's account has had another deferred variable annuity exchange within the preceding 36 months." The proposal would eliminate the reference to an "account."

42 Id.

43 See FINRA's Response, supra note 7.

44 Id.

45 Id.

46 Id.

D. Effective Date of the Proposed Amendments

Some commenters requested a delay in the effective date of the proposed rule change of between 12 and 18 months.[47] One commenter stated that the method by which the effective dates would be determined has been confusing. [48] Although FINRA believes that a delay of 12 to 18 months would be unreasonably long, [49] it nevertheless agreed to delay the effective date until 240 days following publication of the Regulatory Notice announcing Commission approval. FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning whether the proposed rule change as modified by Amendment Nos. 1 and 2 is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2008-019 on the subject line.

Paper Comments:

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47 See e.g., ACLI Letter, CAI Letter.

48 See CAI Letter II.

49 See FINRA's Response, supra note 7.

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2008-019. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2008-019 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Discussion and Findings

After careful review of the proposal and consideration of the comment letters and FINRA's Response, the Commission finds that the proposed rule change, as amended, is

consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to FINRA.[50] In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,[51] which requires, among other things, that FINRA's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission finds that the proposed rule change, as amended, is reasonably designed to accomplish these ends by creating a mechanism through which policies and procedures that are designed to ensure that recommended variable annuity transactions are properly identified and subject to timely principal review are put in place. As FINRA noted, while most variable annuity transactions are "recommended," whether by a registered representative or an Internet-based computer system, and thus would be subject to principal review, there are some broker-dealers that do not make any recommendations as part of a business model that provides lower cost products. [52] The Commission believes that principal review is less necessary when a particular variable annuity transaction is not recommended. Accordingly, the Commission believes that the rule change strikes the proper balance between investor protection and efficiency by requiring principal review of recommended transactions while, at the same time, removing an unnecessary impediment to the purchase of these investments by investors who do not

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

51 15 U.S.C. 78o-3(b)(6).

52 See FINRA's Response, supra note 7.

need or seek a recommendation.

In addition, the Commission believes that FINRA struck a reasonable balance with regard to the timeframe during which variable annuity transactions must be reviewed by a principal. Requiring the seven-business-day review requirement to begin at the time that a signed and completed application is received by an OSJ will encourage the OSJ that received the application to route it, within a reasonable time, to the principal required to review it. We are not persuaded that the principal review clock should begin to run when any office of a broker-dealer receives an application because of the practical delays often associated with processing an application and routing it to the appropriate person. We also are not persuaded that the principal review clock should be delayed until a particular OSJ receives the application, because doing so could result in undue delays to the prompt processing and completion of an investor's transaction.

The Commission gave careful consideration to the comments raised regarding the forwarding of customer funds during the period when an application is under principal review. We believe that until a transaction has been approved or denied, segregation of customer funds in a special account similar in form and function as those described in Exchange Act Rules 15c3-3(k)(2)(i) and 15c3-3(f)[53] offers the best assurance that investors' funds will be safeguarded in a manner that most closely parallels the protective features of the federal securities laws, and that investors in different products should receive similar treatment. Specifically, when an investor purchases a non-variable annuity investment through a broker-dealer, she is protected by the Securities Investor Protection Corporation in the event the broker-dealer becomes insolvent. Because

53 17 CFR 240.15c3-3(k)(2)(i), 15c3-3(f).

insurance companies are subject to a different regulatory scheme than broker-dealers, including differences resulting from variation in state insurance laws, we believe deferred variable annuity investors are best protected by a rule that closely mimics the protections and safeguards governing other investors. Consequently, we believe that FINRA's proposed rule change strikes a fair balance between the practical needs of broker-dealers associated with transmitting funds to insurance companies and protecting investors from the possibility that an insurance company may become insolvent.

With regard to FINRA's proposed requirement that broker-dealers determine the number of prior customer exchanges, the Commission agrees with FINRA that it is reasonable and appropriate for a broker-dealer to be required to determine the number of exchanges that have occurred at the firm itself. We believe this burden should be minimal, in that the broker-dealer will have ready access to that information from its books and records. The Commission also believes that it is reasonable to rely on a customer's representations regarding exchanges conducted at other firms given that most customers are in a good position to know whether they have made any exchanges. While a customer's recollection of this information may not always be fully accurate, the burdens associated with requiring broker-dealers to obtain this information through other means outweigh the benefits of any potential improvement in accuracy. Moreover, this requirement is designed to help ensure that broker-dealers ask about customers' exchanges in a manner that is reasonable calculated to elicit accurate responses from customers when they are asked about exchanges at other broker-dealers.

Finally, given the rule's operational impact, we believe that it is appropriate for its effective date to be delayed by 240 days following publication of the Regulatory Notice

announcing Commission approval. This should provide sufficient time for broker-dealers and any other affected parties to make necessary changes to their systems and procedures without undue further delay of the rule's implementation.

In approving Rule 2821, the Commission took note of the numerous examinations of, and enforcement actions against, broker-dealers involving the sale of variable annuity products.[54] We understood that many FINRA enforcement actions against broker-dealers involved unsuitable recommendations of variable annuities and noted that the rule was designed to curb these sales practice abuses.[55] Rule 2821 has been subject to a thorough notice and comment process, and these amendments to the rule respond directly to comments and questions raised by commenters. For that reason, we believe that it is appropriate to finalize the rule in order to provide broker-dealers and others affected by it with the clarity needed to make operational and systems changes required to implement the rule and achieve the investor protections for which it is designed. Accordingly, based on the foregoing reasons, the Commission believes that good cause exists, consistent with Sections 15A(b)(6)[56] and 19(b)(2)[57] of the Exchange Act, to approve the proposed rule change.

The Commission also finds good cause for approving the proposed rule change as modified by Amendment Nos. 1 and 2 prior to the thirtieth day after the date of publication of notice in the Federal Register. Amendment No. 1 originally indicated that funds had to remain in a segregated bank account until such time as the insurance

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54 See Securities Exchange Act Release No. 56375 (September 7, 2007), 72 FR 52403, 52411 (September 13, 2007).

55 Id.

56 15 U.S.C. 78o-3(b)(6).

57 15 U.S.C. 78s(b)(2).

company is notified of the broker-dealer's approval or rejection of the application. Under the rule as amended by Amendment No. 1, there could be delays between the time when a principal approves an application and the time when an insurer receives the approved application (e.g., when a broker-dealer conveys principal approval to an insurer electronically but sends an approved application via regular mail), thereby creating a situation where the funds in a suspense account are released before the insurance company has received the application necessary to issue the contract. Therefore, Amendment No. 2 clarifies that the insurance company must receive both a notification of approval and the application before funds can be released from the suspense account. Because these amendments do not significantly alter the proposed rule, which was subject to a full notice and comment period, the Commission finds that it is in the public interest to approve the proposed rule change, as modified by Amendment Nos. 1 and 2, as soon as possible to expedite their implementation. Accordingly, the Commission finds that there is good cause, consistent with and in furtherance of the objectives of Sections 15A(b)(6)[58] and 19(b)(2)[59] of the Exchange Act, to approve Amendment Nos. 1 and 2 on an accelerated basis.

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58 15 U.S.C. 78o-3(b)(6).

59 15 U.S.C. 78s(b)(2).

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,[60] that the proposed rule change (SR-FINRA-2008-019), as modified by Amendment Nos. 1 and 2, be and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[61]

Florence E. Harmon
Deputy Secretary

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60 15 U.S.C. 78s(b)(2).

61 17 CFR 200.30-3(a)(12).