

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57228; File No. SR-FINRA-2007-040]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change to Delay Implementation of Certain FINRA Rule Changes Approved in SR-NASD-2004-183

January 29, 2008.

#### I. Introduction

On December 21, 2007, the Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("Commission") pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to delay the effective date of paragraph (c) of NASD Rule 2821 until August 4, 2008. The Commission published the proposed rule change for comment in the *Federal Register* on January 3, 2008.<sup>3</sup> The Commission received fourteen comments on the proposed rule change. This order approves the proposed rule change.

#### II. Description of the Proposal

The Commission approved NASD Rule 2821 on September 7, 2007.<sup>4</sup> Rule 2821 created recommendation requirements (including a suitability obligation), principal review and approval requirements, and supervisory and training requirements tailored specifically to transactions in deferred variable annuities.

On November 6, 2007, FINRA published *Regulatory Notice* 07-52, which announced the Commission's approval of Rule 2821 and established May 5, 2008 as the effective date of the rule. FINRA is proposing to delay the effective date of paragraph (c), which addresses principal review and approval, until August 4, 2008.

According to FINRA, several firms requested that the effective date of the

rule be delayed to allow firms additional time to make necessary systems changes. Firms also raised various concerns regarding paragraph (c) of the rule. With respect to the timing of principal review, firms stated that seven business days beginning from the time when the customer signs the application may not allow for a thorough principal review in all cases. These firms have asked that a different timing mechanism be used. Firms also questioned whether broker-dealers that do not make any recommendations to customers should be subject to paragraph (c) of the Rule. And finally, firms asked FINRA to reconsider its statement in Regulatory Notice 07-53 that Rule 2821(c) does not permit the depositing of a customer's funds in an account at the insurance company prior to completion of principal review.

FINRA staff believes it is prudent to give further consideration to paragraph (c) of Rule 2821 and the interpretation addressed in the *Regulatory Notice* to determine whether certain unintended and harmful consequences might ensue upon the currently scheduled effective date of May 5, 2008. If, based on this review, FINRA concludes that further rulemaking is warranted, it stated that it will file a separate rule change with the Commission.

#### III. Summary of Comments

The Commission received fourteen comments on the proposed rule change. All commenters supported FINRA's proposal to extend the effective date of the principal review and approval requirements contained in paragraph (c) of Rule 2821 until August 4, 2008.<sup>5</sup>

<sup>5</sup> See, e.g., Letters from Darrell Braman and Sarah McCafferty, T. Rowe Prince Investment Services, Inc. (Jan. 23, 2008) ("T. Rowe Price Letter"); Michael P. DeGeorge, General Counsel NAVA (Jan. 24, 2008) ("NAVA Letter"); Clifford Kirsch and Eric Arnold, Partners, Sutherland Asbill & Brennan LLP on behalf of the Committee of Annuity Insurers (Jan. 24, 2008) ("Comm. Annuity Insurers Letter"); Stuart Kaswell, Partner, Dechert LLP on behalf of TIAA-CREF (Jan. 24, 2008) ("Dechert Letter"); Heidi Stam, Managing Director and General Counsel, Vanguard (Jan. 24, 2008) ("Vanguard Letter"); David E. Stone, Vice President and Associate General Counsel, Charles Schwab & Co., Inc. (Jan. 24, 2008) ("Schwab Letter"); Heather Traeger, Assistant Counsel, Investment Company Institute (Jan. 24, 2008) ("ICI Letter"); Dale E. Brown, President and Chief Executive Officer, Financial Services Institute (Jan. 25, 2008) ("FSI Letter"); Carl B. Wilkerson, Vice President, American Council of Life Insurers (Jan. 28, 2008) ("ACLI Letter"); Amal Aly, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (Jan. 29, 2008) ("SIFMA Letter").

One commenter stated, however, that waiting until August to determine the principal review and approval standard could cost the industry millions of dollars in unnecessary expenditures if FINRA revises the rule. See Letter from Douglas A. Wright, CCO, The Investment Center, Inc. (Jan. 14, 2008). This commenter believed a delay in enacting Rule

Commenters agreed that additional time is needed to consider the impact those requirements will have on member firms and for FINRA to consider suggested alternatives.<sup>6</sup>

In addition to supporting the extended effective date of paragraph (c), commenters also expressed concerns and proposed alternatives with respect to three aspects of the principal review and approval requirements of paragraph (c). Some commenters suggested that FINRA eliminate the principal review requirement for non-recommended transactions.<sup>7</sup> According to commenters, some broker-dealers do not solicit purchases of deferred variable annuities and do not recommend any transactions.<sup>8</sup> For broker-dealers with this type of business model, commenters believed principal review and approval is unnecessary and does not further the purposes of the rule.<sup>9</sup> One commenter stated that an exemption from the principal review requirements only for those broker-dealers that do not make any recommendations to customers would disadvantage broker-dealers who have various business models, some models allowing recommendations and others that do not.<sup>10</sup> This commenter suggested that FINRA require a broker-dealer that offers recommendations to some customers and not to others to institute policies and procedures ensuring that the broker-dealer perform a principal review for recommended transactions.<sup>11</sup>

Six commenters also believed that FINRA should allow broker-dealers to forward customer checks to the issuing insurance company and allow the issuing insurance company to deposit customer funds into a suspense account prior to the completion of principal

2821(c) would be welcomed by most firms to allow for systems upgrades, but firms do not want to begin paying for one system only to have FINRA alter the rule. *Id.* Another commenter addressed his broker-dealer's individual situation regarding net capital obligations. See Letter from Jeremiah O'Connell (Jan. 4, 2008).

<sup>6</sup> See, e.g., Comm. Annuity Insurers Letter; Dechert Letter; FSI Letter; SIFMA Letter; Vanguard Letter.

<sup>7</sup> See ACLI Letter; Dechert Letter; ICI Letter; NAVA Letter; SIFMA Letter; Vanguard Letter.

<sup>8</sup> See Dechert Letter; ICI Letter; NAVA Letter; T. Rowe Price Letter; Vanguard Letter.

<sup>9</sup> See Dechert Letter; ICI Letter; NAVA Letter; Vanguard Letter. Some commenters emphasized that under these types of business models, firms do not pay commissions. See Dechert Letter; Vanguard Letter. One commenter also noted that its policies and procedures prohibit registered representatives from recommending any transactions. Vanguard Letter.

<sup>10</sup> See Dechert Letter

<sup>11</sup> *Id.*

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Exchange Act Release No. 57050 (Dec. 27, 2007); 73 FR 0531 (Jan. 3, 2008) (SR-FINRA-2007-040).

<sup>4</sup> See Order Approving FINRA's NASD Rule 2821 Regarding Members' Responsibilities for Deferred Variable Annuities ("Approval Order"), Securities Exchange Act Release No. 56375 (Sept. 7, 2007), 72 FR 52403 (Sept. 13, 2007) (SR-NASD-2004-183); Corrective Order, Securities Exchange Act Release No. 56375A (September 14, 2007), 72 FR 53612 (Sept. 19, 2007) (SR-NASD-2004-183) (correcting the rule's effective date).

review.<sup>12</sup> Commenters stated customer funds could be held in these accounts and would not result in the issuance of a contract until principal review has been completed.<sup>13</sup> Some commenters also stated that customer funds could be refunded in the event a contract is not issued.<sup>14</sup>

Eight commenters suggested that FINRA revise the timing of principal review requirement.<sup>15</sup> Paragraph (c) requires a registered principal to review a transaction and determine whether he or she approves of it prior to transmitting the customer's application to the issuing insurance company for processing, but no later than seven business days after the customer signs the application.<sup>16</sup> Commenters stated that beginning the seven business day review period from the time when the customer signs the application is problematic because often the customer signs and mails the application, leaving the broker-dealer no control over the timing.<sup>17</sup> Commenters also stated that they have no control over which means a customer uses to mail an application and how long it takes for that application to arrive at the broker-dealer.<sup>18</sup> Some commenters suggested that the principal review process be required to be completed seven business days after the broker-dealer has received an application "in good order."<sup>19</sup> Other commenters suggested that the seven-day period should begin when the broker-dealer receives the application

<sup>12</sup> See Letter from MaryAnn Lamendola, Chief Compliance Officer, Chase Investment Services Corporation (Jan. 24, 2008) ("Chase Letter"); ACLI Letter; Comm. of Annuity Insurers Letter; Dechert Letter; NAVA Letter; SIFMA Letter. One of these commenters believes that both the broker-dealer and the issuing insurance company should be allowed to negotiate checks upon receipt. See Dechert Letter. This commenter noted that customers may send back an application and one check to cover a variable annuity and other investment options, including mutual funds. *Id.* In this situation, the commenter stated there is a conflict between NASD Rule 2830(m), which requires the prompt purchase of mutual fund shares, and Rule 2821(c), which requires the broker-dealer to hold the customer's check pending principal review. *Id.*

<sup>13</sup> See ACLI Letter; Comm. of Annuity Insurers Letter; Dechert Letter. One commenter noted this could be accomplished by the broker-dealer developing controls to ensure that a variable annuity is not issued until after the completion of principal review. Chase Letter.

<sup>14</sup> *Id.*

<sup>15</sup> See Letter from Barbara Gill, Deputy Director of Regulatory Affairs, Stifel, Nicolaus & Company, Inc. (Jan. 22, 2008) ("Stifel Letter"); Comm. of Annuity Insurers Letter; Dechert Letter; FSI Letter; ICI Letter; NAVA Letter; SIFMA Letter; Schwab Letter.

<sup>16</sup> See NASD Rule 2821(c).

<sup>17</sup> See, e.g., Comm. of Annuity Insurers Letter; Dechert Letter; SIFMA Letter; Stifel Letter.

<sup>18</sup> *Id.*

<sup>19</sup> See, e.g., ACLI Letter; ICI Letter; T. Rowe Price Letter.

and the broker-dealer reasonably deems the application is complete.<sup>20</sup>

Two commenters requested that FINRA propose a single implementation date for the entire rule.<sup>21</sup> These commenters stated that establishing two different compliance dates would create confusion when implementing the proposed rule as well unnecessary and redundant system design costs.<sup>22</sup> Paragraph (d) requires members to establish supervisory procedures reasonably designed to achieve compliance with the rule and paragraph (e) require members to develop training policies and programs to ensure compliance with the rule. One of these commenters believed imposing two separate compliance dates would require broker-dealers to provide duplicate sets of supervisory procedures to account for what the rule requires on May 5, 2008 and for what it requires on August 4, 2008.<sup>23</sup> It also stated broker-dealers would have to implement one training program for the part of rule becoming effective on May 5, 2008 and another training program for principal review starting on August 4, 2008.<sup>24</sup>

#### IV. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change and the comments, and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association. In particular, the Commission finds that the proposed rule change is consistent with section 15A(b)(6) of the Act, which requires, among other things, that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.<sup>25</sup>

The proposed rule change does not change any of the substantive provisions of Rule 2821. It allows broker-dealers additional time to comply with one portion of the rule and provides FINRA with additional time to further consider its members' concerns. It is consistent

<sup>20</sup> See Comm. of Annuity Insurers Letter; Dechert Letter; FSI Letter; NAVA Letter; Schwab Letter. Three commenters also specified that the seven days should not begin to run until a complete application is specifically received by the broker-dealer's Office of Supervisory Jurisdiction. See Comm. of Annuity Insurers Letter; Dechert Letter; SIFMA Letter.

<sup>21</sup> See ACLI Letter; Dechert Letter.

<sup>22</sup> *Id.*

<sup>23</sup> See Dechert Letter.

<sup>24</sup> *Id.*

<sup>25</sup> 15 U.S.C. 78o-3(b)(6).

with the requirements of the Act for FINRA to further consider paragraph (c) of Rule 2821 and its related Regulatory Notice to determine whether any unintended or harmful consequences might ensue upon the current effective date.

#### V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>26</sup> that the proposed rule change (SR-FINRA 2007-040) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>27</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57247; File No. SR-FINRA-2008-002]

#### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Reflect That the NASD/NYSE Trade Reporting Facility Does Not Support the Three-Party Trade Report Functionality

January 31, 2008.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 28, 2008, the Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a the National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared substantially by FINRA. FINRA has filed this proposal pursuant to section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

<sup>26</sup> 15 U.S.C. 78s(b)(2).

<sup>27</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> FINRA has asked the Commission to waive the 30-day operative delay provided in Rule 19b-4(f)(6)(iii). 17 CFR 240.19b-4(f)(6)(iii).