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September 23, 2016

VIA ELECTRONIC MAIL

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

Re: FINRA Regulatory Notice 16-29
Gifts, Gratuities and Non-Cash Compensation Rules

Dear Ms. Asquith:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),[1] in response to Regulatory Notice 16-29, *Gifts, Gratuities and Non-Cash Compensation Rules* (the "Notice," or "RN 16-29") issued by the Financial Industry Regulatory Authority, Inc. ("FINRA").[2] The Notice requests comments on proposed amendments to FINRA Rule 3220 (Influencing or Rewarding Employees of Others) ("Rule 3220") and adoption of new FINRA Rules 3221 (Restrictions on Non-Cash Compensation) ("Rule 3221," or "Non-Cash Rules") and 3222 ("Rule 3222," sometimes referred to together with Rule 3220 and Rule 3221 as the "Proposed Rules").

THE PROPOSED RULES

The Proposed Rules follow up on FINRA's April 2014 retrospective rule review of its gifts, gratuities and non-cash compensation rules ("rule set"). The Committee commented on that rule review in 2014.[3] Following that rule review, FINRA published its report which provided several potential next steps for revising the rule set ("2014 Report"). As indicated in the Notice, FINRA has proposed, among others, the following changes to the rule set:

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

[2] RN 16- 29 is available here.

[3] A copy of the Committee's comment letter is available: here ("2014 Comment Letter").

- Consolidating the rule set under a single rule series in the FINRA rulebook;
- Increasing the gift limit from $100 to $175 per person per year;
- Amending the non-cash compensation rules to cover all securities products, rather than only direct participation programs, variable insurance contracts, investment company securities and public offerings of securities;
- Incorporating existing guidance and interpretive letters into the rule set;
- Amending the rules for internal sales contests for non-cash compensation such that if payment or reimbursement of expenses associated with the non-cash compensation arrangement is preconditioned on achievement of a sales target, the non-cash compensation arrangement must: (1) be based on the total production with respect to all securities products; and (2) not be based on conditions that would encourage an associated person to recommend particular securities or categories of securities; and
- Incorporating a principles-based standard for business entertainment that would require firms to adopt written policies and supervisory procedures for business entertainment.

COMMITTEE COMMENTS

The Committee appreciates the opportunity to comment on the Proposed Rules. The Committee supports FINRA's efforts to review and refresh its rules through the retrospective rule review process. In addition, the Committee believes that certain of the changes proposed under the Proposed Rules provide increased clarity and rationality. As indicated below, the Committee has identified a number of concerns related to the Proposed Rules, as well as some requests for additional interpretation and clarification.

The Rule 3221 Requirement that *All* Securities Products Must Count Toward Non-Cash Compensation Programs Should Be Modified to Allow Firms to Exclude Certain Tax-Qualified Production. Under Rule 3221(b)(3), any non-cash arrangement between a member and its associated persons, or between a non-member company (such as a company issuing variable annuities) and its sales personnel of an affiliated member firm, must be based on "the total production of associated persons with respect to *all* securities" distributed by the member. The Committee recognizes FINRA's intent to "reduce the potential for conflicts of interest and risks of abuse"[4] from a non-cash program that could favor the recommendation of one type of securities product over another. However, the Committee believes that such programs should be permitted to be structured in a manner that would allow non-cash compensation programs to exclude certain tax-qualified investments.

As you are aware, the Department of Labor's newly adopted fiduciary rule (the "DOL Rule") imposes significant limitations on any non-cash compensation program offered in

[4] RN 16-29 at p. 7.

connection with the tax-qualified accounts covered under DOL Rule ("covered accounts").[5] In order to meet the terms of the DOL Rules, some firms and affiliated non-members have been contemplating restructuring their historical non-cash compensation programs to eliminate providing credit for production in covered accounts. The Committee requests that Rule 3221 be reconsidered in light of the implications arising under the DOL Rule for non-cash compensation, and that Rule 3221 be revised to allow firms to exclude securities products held in covered accounts from the "total production" requirements under Rule 3221(b)(3)(A)(ii)(a). The Committee believes that the types of point-of-sale incentives FINRA is attempting to guard against here (*e.g.*, choosing to offer a customer a proprietary product, or a type of securities product that could generate higher non-cash compensation awards) are not significantly impacted by allowing covered accounts to be excluded from the total production requirements.

The New Standard under Rule 3221(b)(3) Is Overly Broad and May Be Unworkable. Under Proposed FINRA Rule 3221, a non-cash compensation program offered by a member (or a member's affiliate like an insurance company) must not be "based on conditions that would encourage an associated person to recommend particular securities or categories of securities" (the "Section (b) Standard").[6] The Committee is concerned that the Section (b) Standard is too broad, and may make it extremely difficult to construct metrics for qualification for a non-cash program that are clearly compliant with the Section (b) Standard. For example, it does not appear that non-cash compensation programs could be constructed by providing credit through gross dealer concession ("GDC") since GDC varies with the type of securities product sold. For example, a $10,000 investment in securities product "X" might produce a higher GDC than a $10,000 investment in securities product "Y." It appears that under the Section (b) Standard, the non-cash incentive program would therefore impermissibly "encourage" the registered person to recommend securities product X that generates higher GDC based on the same total dollar amount invested. Another methodology that could neutralize the issues with using GDC as a qualifying metric would be to use the total dollar amount invested for assessing non-cash compensation credit. Even if a firm relied on the total dollars invested, it seems like that could "encourage" certain types of products or transactions that may tend to generate higher total dollar volumes (*e.g.*, IRA Rollovers or other types of securities product purchases).[7]

The Committee believes that FINRA should revise the Section (b) Standard by using qualifying language to modify the degree to which the registered person would be encouraged (*e.g.*, "materially encouraged," "meaningfully encouraged") to favor one product over another. In addition or in the alternative, the Committee believes that it would be beneficial for FINRA to provide examples of the types of non-cash compensation qualification criteria that it believes meet the Section (b) Standard.

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[5] The DOL Rule was issued in April 2016 in a series of releases, including but not limited to the following: *Best Interest Contract Exemption*, 68 Fed. Reg. 21,002 (Apr. 8, 2016); *Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice*, 68 Fed. Reg. 20,946 (Apr. 8, 2016).

[6] Rule 3221(b)(3)(A)(ii)(b).

[7] It appears possible that attempting to generate a non-cash compensation program metric that does not "encourage" one class of securities products over another may be limited by the FINRA-permitted compensation model that allows cash compensation practices to vary among securities products.

The Committee Is in Favor of Permitting Otherwise Permissible Business Entertainment at a Training and Education Meeting. The Committee has previously commented on this and was disappointed that the Non-Cash Rules did not provide for this after the tone and tenor with which this issue was discussed in the 2014 Report. The Committee continues to believe that such entertainment should be permissible. As we stated in our 2014 Letter, the Committee believes that FINRA's position that an offeror cannot pay for business entertainment while at a meeting it sponsors for the purpose of training or education is overly broad and prescriptive. These meetings are already subject to numerous safeguards that prevent them from becoming overly lavish, as set forth under Rule 3221(b)(2), such as:

- The limits on the appropriate location for the meeting;
- The prohibition on reimbursement of the costs for guests of the associated person;
- The obligation for the training to occupy "substantially all of the work day."[8]

As a result of those limitations, the Committee believes that providing business entertainment associated with the meeting that complies with the business entertainment provisions of Rule 3222 should be permissible. Allowing measured entertainment should not impact the status of the meeting as "first and foremost intended to . . . provide training or education to an associated person."[9]

Location of Training and Education Meetings. Rule 3221(b)(2)(B) appears to require that a training and education meeting must be held in the United States ("US"). The Committee believes that in certain circumstances, it should be permissible for such meetings to occur outside of the US, particularly where such meetings are held in a country that borders the US in which the firm or offeror may have a business location. The Committee recommends that Rule 3221(b)(2)(B) be revised to permit meetings outside the US when such meetings otherwise meet the articulated standards of the Rule (*e.g.*, an office or facility of the member or offeror, or a facility located within the vicinity of such office).[10]

The Gift Limit under Rules 3221 and 3222 Should be Raised to $200 or those Rules Should Provide for Automatic, Periodic Increases of the Limit. The Committee recognizes that FINRA relied on data related to the rate of inflation to set the $175 limit and understands the rationality of that approach. However, given that it has been nearly 25 years since the dollar amount was increased, and additional increases by FINRA over the next 10 years or so seem unlikely, the Committee recommends that the permitted gift amount be set at $200. In the alternative, the Committee suggests that a formalized recalculation be embedded in the applicable Rule that allows for increases on some periodic basis (*e.g.*, every 5 years).

Applicability of Rule 3222 to Offeror and Firm Entertainment. The Committee request clarification that the provisions of Rule 3222 are now designed to cover firm activities that were formerly addressed and permitted under the current non-cash compensation rules such

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[8] *See* Rule 3221 SM.06.
[9] *Id.*
[10] The Committee also notes that so-called "diligence" trips are often viewed by FINRA exam staff as needing to comply with this requirement. Such trips in certain situations may require firms to travel outside of the US.

as FINRA Rule 3220(g)(4)(B)(the exception permitting "an occasional meal, a ticket to sporting event or the theater"). Stated alternatively, the provision of tickets to the theater or sporting events to or from a member firm that previously needed to conform to the non-cash compensation rule exception, now are treated instead as subject to the principles-based rules of the business entertainment rule (Rule 3222). The Committee is requesting that FINRA confirm this interpretation.[11]

Implementation Period Prior To Compliance Date. The Proposed Rules create a number of operational and other challenges. The Committee feels strongly that the Proposed Rules, once finalized, should have at least a one-year period to allow firms to appropriately train and educate their personnel and to develop and implement their new policies, systems and forms under the Proposed Rules.

CONCLUSION

The Committee appreciates the opportunity to comment on the Proposed Rules. The Committee would be pleased to meet with FINRA staff to discuss the comments in this letter and provide additional feedback to FINRA on the implications of moving forward with the Proposed Rules. Please do not hesitate to contact Eric Arnold (202.383.0741), Cliff Kirsch (212.389.5052) or Susan Krawczyk (202.383.0197) if you have any questions regarding this letter.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: _____
Eric Arnold

BY: _____ EA
Cliff Kirsch

BY: _____ EA
Susan Krawczyk

FOR THE COMMITTEE OF ANNUITY INSURERS

[11] RN 16-29 (at page 8) indicates that Rule 3222 is designed "to replace the business entertainment standard in the existing non-cash compensation rules and the 1999 letter."

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
USAA Life Insurance Company
Voya Financial, Inc.