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John F. Hahn
2nd Vice President
Practice Leader – FI Bonds
Bond and Financial Products
One Tower Square S203A
Hartford, CT 06183
phone 860.277.1952
fax 860.277.3932
JHahn@travelers.com

September 14, 2009

Ms. Marcia E. Asquith
Senior Vice President and Corporate Secretary
FINRA
1735 K Street, NW
Washington DC 20006-1500

RE: Request For Comments – Regulatory Notice 09 – 44 Proposed Consolidated FINRA Rule Governing Fidelity Bonds

Dear Ms. Asquith:

Travelers provides many specialty insurance products to members of the financial institution industry including FINRA regulated firms. We are pleased to have an opportunity to review and comment on the proposed rule change noted above.

Our first comment deals with the change guiding firms to the Securities Dealers Bond as the FINRA required bond form. From what we understand, the insurance market is currently limited to only two underwriters who have elected to provide this bond. Most of the other underwriters who provide financial institution bond coverage to FINRA members do not have this product in their portfolio and are limited to the Form 14 which is the industry standard for broker-dealers. This change will put these other underwriters at a distinct competitive disadvantage. We suspect one reason why there may be such little support for this form in the broader insurance market is due to its significant breath of coverage and very low premium. Travelers encourages FINRA to continue to focus the bonding requirement on the Form 14, which is broadly available in the market, with the Securities Dealers Bond as an alternative instead of the preferred solution.

The rule change could also be perceived as driving FINRA members to one of two programs - one of which is sponsored by FINRA. Not only does this focus the business on the two underwriters offering the form, it also focuses a significant portion of the business on the two distributors of these financial institution bonds. This change in the rule has the potential of disrupting local relationships with insurance producers who have other business relationships with the FINRA member unless these producers are willing to "wholesale" the business through the exclusive distributors as intermediaries.

If the Securities Dealers Bond is the preferred form of coverage, it is very different from other financial institution bonds. Among other features, there is the absence of an aggregate limit of liability. This is the “per year” coverage described in the Regulatory Notice 09 – 44. The aggregate limit is important to most underwriters as it quantifies and controls the underwriter’s maximum exposure to loss during the bond period. The Regulatory Notice enables firms to satisfy the rule with a Form 14 “which is otherwise consistent with the requirements of the proposed rule”. Travelers would appreciate some clarification on what this means. Does that mean the Form 14 cannot have an aggregate limit? If that is the case, our opinion is that this will diminish the appetite of the underwriters who currently provide Form 14’s. For those that elect to continue without an aggregate limit, securing adequate premium is likely to increase the cost of the protection.

Travelers concurs with the change increasing the minimum bond limit requirements. This is clearly in the public’s interest and in the spirit of investor protection. Our experience shows many of the smaller firms seem to be guided by the regulatory required (minimum) limit versus a more comprehensive assessment of their exposure to loss in their bond limit selection. We do see losses that exceed the current bond limit which exposes the firm’s net capital. In some cases the scale of the loss in excess of the bond’s limit makes the firm the subject of a SIPC liquidation proceeding.

The Minimum Required Coverage provisions of the proposed rule seem to be relaxed for the limit required for the Securities (Insuring Agreement E) limit. In our opinion, that agreement’s limit should be equivalent to the amount required for Fidelity due to the significant loss potential of that coverage. Premium savings for reducing that limit would not be significant. In addition, we encourage FINRA to incorporate a requirement for a limit on Computer Theft equivalent to Fidelity. Additional premium is nominal; and in our opinion, this insuring provision is likely to be the subject of increasing loss activity. Without this protection, the firm’s net capital is fully exposed to loss.

We welcome the proposed change deleting the reference to “Fraudulent Trading” as a required insuring agreement. While the Form 14 and the Securities Dealers Bond do not exclude losses involving trading where the Fidelity insuring agreement applies, there is no coverage referred to as “Fraudulent Trading”. It is our observation that this has been the cause of confusion from time to time when an examiner was reviewing a regulated firm’s insurance program for compliance.

Travelers is pleased to see an increase in the maximum permissible deductible thresholds. When a firm has underwriting issues, the underwriter will generally require some increase in deductible. If the underwriter is unable to increase it above a predetermined maximum, that may have consequences in its willingness to provide coverage. However, the proposed rule provides a very strong disincentive for firms to accept or pursue these higher deductibles should the firm have to take a haircut in its net capital computation for deductibles which exceed 10% of the bond limit. For this reason, Travelers encourages the deletion of this latter net capital computation requirement.

We strongly encourage FINRA to consider an additional exception in the proposed rule when the firm is an element of a larger, diversified financial services parent. The parent's financial intuition bond program will in almost all cases cover the FINRA regulated subsidiary as an additional insured with a substantial limit of liability that is a multiple of the minimum bond limit requirement. However, the parent also is subject to a deductible reflecting the scope of their operations and appetite for self-insuring risk. With the appropriate parental commitment to the subsidiary to which the FINRA bond requirements apply, we feel this treatment provides a greater degree of investor protection and is in the public's interest.

In the proposed exemption changes, Travelers strongly recommends that one-person firms should continue to be exempt from the rule as in NASD Rule 3020. The alter ego concept applies to claims, specifically fidelity claims for these entities. If the owner/principal is the perpetrator of a loss, proceeds from the claim resolution would flow to the perpetrator without this exemption. This puts the underwriter in an untenable position. We expect that most underwriters will have a fundamental issue with this change.

Lastly, if there are changes in the rule, it is likely there will need to be revisions in underwriting rating methodology to address limit and deductible changes. After rates are revised by underwriters subsequent to an actuarial review, the changes must be filed with and approved by the state insurance departments. This process does not always move on a timeline underwriters can control. Accordingly, we request that this process be contemplated in the determination of the effective date of the new rule.

Travelers appreciates the opportunity to provide our input into this process.

Respectfully,

John F. Hahn