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May 13, 2011

Marcia E. Asquith
Senior Vice President and Corporate Secretary
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 11-14: Third-Party Service Providers

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 11-14, "Third-Party Service Providers" (the "Notice"). In the Notice, FINRA requests comments on a proposed new rule that clarifies a member firm's obligations and supervisory responsibilities regarding outsourcing arrangements. The Notice identifies proposed new FINRA Rule 3190 (Use of Third-Party Service Providers) (the "Proposed Rule").

THE PROPOSED RULE

The Notice explains that the Proposed Rule responds to FINRA's concerns about member firms' increasing use of outside entities to perform certain activities related to their business operations and the compliance risks that may accompany the use of such outside entities. FINRA notes that although it has provided substantial guidance regarding member firms' responsibilities when outsourcing functions to third-party service providers, it has continued concerns about the scope of functions that may be outsourced and the appropriateness of certain outsourcing activities to a third-party service provider that is not registered as a broker-dealer.

The Notice indicates that Proposed Rule 3190 would clarify that a member firm is obligated to comply with applicable securities laws and regulations and FINRA and Municipal Securities Rulemaking Board ("MSRB") rules when it enters into arrangements that outsource

[1] The Committee of Annuity Insurers is a coalition of 32 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over two-thirds of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

functions or activities related to its business as a regulated broker-dealer to a third-party service provider (including any sub-vendor), and that the broker-dealer retains full liability and accountability for all activities outsourced to a service provider as if it conducted those activities. Supplementary Material to the Proposed Rule would explain that the term "third-party service provider (including any sub-vendor)" includes any person controlling, controlled by, or under common control with a member firm, unless otherwise determined by FINRA.[2] In addition, the Proposed Rule would make clear that any person engaging in activities that require registration and qualification under FINRA rules must acquire such registrations and qualifications to be able to perform such activities on behalf of a member firm.

The general provisions of the Proposed Rule would require each member firm to establish and maintain as part of its supervisory system and written procedures (pursuant to NASD Rule 3010) provisions for the activities performed by a third-party service provider. More specifically, Proposed Rule 3190(b) would require a member firm to conduct ongoing due diligence of each current and prospective third-party service provider to determine at a minimum whether:

- the service provider is capable of performing the activities being outsourced to it; and whether
- the member firm can achieve compliance with applicable securities laws and rules with respect to any functions being outsourced.

The Notice indicates that the Proposed Rule would require heightened oversight and supervisory procedures for clearing and carrying firms. A clearing or carrying firm would be required to vest an associated person of the firm with authority and responsibility for the following activities:

- the movement of customer or proprietary cash or securities;
- the preparation of net capital or reserve formula computations; and
- the adoption or execution of compliance and risk management systems.

In addition, a clearing or carrying member would be required to maintain procedures that:

- enable the firm to take prompt corrective action where necessary to achieve compliance with applicable securities laws and regulations as well as applicable FINRA and MSRB rules; and

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[2] Proposed Supplementary Material .01.

- require the member to approve any transfer of duties by a third-party service provider to a sub-vendor.

Proposed Rule 3190 would mandate that clearing and carrying member firms notify FINRA within 30 days following the execution of any outsourcing agreement with a third-party service provider that is covered by the Proposed Rule. The Notice indicates that member firms would be required to adopt any necessary amendments to existing contracts with third-party service providers after the adoption of the Proposed Rule.

The Notice explains that Proposed Rule 3190 would not apply to "ministerial activities" performed on behalf of a member firm, unless otherwise prohibited by applicable securities laws and regulations or applicable FINRA or MSRB rules, nor would it restrict activities performed pursuant to a carrying agreement approved under FINRA Rule 4311.

COMMITTEE COMMENTS ON THE PROPOSED RULE

The Committee commends FINRA for undertaking the proposed rulemaking in an effort to protect investors, and appreciates the opportunity to provide comments on the Proposed Rule. In general, the Committee believes many aspects of the Proposed Rule need to be clarified and that the reach of the due diligence requirements and the heightened restrictions on clearing and carrying member firms should be circumscribed. Set forth below are the Committee's detailed comments on the Proposed Rule.

Scope of Third-Party Service Provider Definition

Proposal. Proposed Rule 3190 includes Supplementary Material .01 (Scope of Third-Party Service Provider) which would provide that the term "third-party service provider (including any sub-vendor)" shall include any person controlling, controlled by, or under common control with a member, unless otherwise determined by FINRA.

Comments. The Committee requests that the definition of third-party service provider be better tailored to account for broker-dealers that are part of a larger financial services firm. More specifically, the Committee believes FINRA should revise Supplementary Material .01 of the Proposed Rule to provide that a "third-party service provider" will not include those legal entities within a financial services company that employ individuals who provide services to an affiliated broker-dealer where such individuals are registered persons of the broker-dealer or are non-registered fingerprinted persons. Broker-dealers that are part of larger financial services firms routinely rely on affiliated entities sharing or providing services to various legal entities within the larger firm umbrella. As a result, some individuals may be employed by an entity controlling, controlled by, or under common control with a member firm, but may also be registered persons or non-registered fingerprinted persons with the affiliated member firm. In those cases, the Committee believes that the affiliated entities should not be deemed "third-party service providers" and thus, should fall outside the parameters of the Proposed Rule because the individuals performing the "outsourced" functions are already subject to supervisory and compliance oversight of the member firm by virtue of being associated persons of the member firm. Subjecting the affiliated entities that employ such individuals to additional and ongoing due diligence and compliance oversight would merely duplicate the member firm's compliance obligations with respect to the outsourced activities without advancing the purposes of the Proposed Rule. Likewise, subjecting member firms to the requirements of Rule 3190 with respect to activities they themselves carry out directly, through personnel who are employees of affiliates, would serve no purpose.

In addition, the Committee strongly believes that FINRA should consider limiting the scope of the term "third-party service provider" to those individuals or entities that are not otherwise regulated by the SEC as broker-dealers or transfer agents. More specifically, the Proposed Rule should exempt member firms from having to adopt supervisory systems or written procedures, or performing due diligence on other SEC-registered broker-dealers or on SEC-registered transfer agents. Outsourced activities performed by another broker-dealer or an SEC-registered transfer agent are already subject to the internal compliance programs of the broker-dealer or transfer agent, and are already subject to regulatory reporting and examination programs. Historically, NASD outsourcing guidance focused on concerns with member firm outsourcing arrangements with entities other than broker-dealers and with unregulated entities.[3] By limiting the scope of the term "third-party service provider" to only those entities currently unregulated, the Proposed Rule would be aligned with a stated purpose of such guidance - to ensure that outsourcing arrangements are in compliance with applicable securities laws and regulations and FINRA rules.[4] The Committee urges that the proposed definition of the term "third-party service provider" be revised so as not to unnecessarily expand historical outsourcing guidance to SEC regulated entities. The proposal does not indicate and we are not aware of wider concerns FINRA may now have for doing so.

In order to avoid confusion among member firms, and in view of the precedent established by previous FINRA guidance, particularly in NTM 05-48, it would be helpful for FINRA to confirm that it does not intend Rule 3190 to conflict with prior guidance. Member

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[3] *See* NASD Notice-to-Members 05-48 (July 2005): Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers ("NTM 05-48") generally and at p. 2, where the Notice acknowledges that "members regularly enter into outsourcing arrangements with entities *other than broker-dealers*." (emphasis added).

[4] NASD Office of General Counsel Interpretive Memorandum, dated August 15, 2006 (A Member's Responsibilities Regarding the Outsourcing of Certain Activities), available at http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P017175.

firms have relied on prior guidance in establishing their outsourcing arrangements. The Committee requests that FINRA provide this confirmation.

Due Diligence Requirements

Proposal. Proposed Rule 3190(a)(2) and (b) would require that a member firm adopt written procedures that include an ongoing due diligence analysis of each current and prospective third-party service provider, including any sub-vendor.

Comments. FINRA previously provided guidance to member firms regarding designing supervisory systems and drafting written procedures for outsourcing arrangements that are appropriately tailored to each member's business structure and operations.[5] The proposed text of Rule 3190 appears consistent with this guidance and the long-standing principle that member firms are in the best position to tailor their supervisory systems to their own business operations. The Committee requests that FINRA confirm that member firms may continue to rely on previous guidance for designing supervisory systems and procedures for outsourcing.

Additionally, the Committee strongly believes that member firms should not be required to perform ongoing due diligence of current or prospective sub-vendors. It is impractical for member firms to know in advance of every instance in which a third-party service provider may seek to retain a sub-vendor for some part of the outsourced activities. Most significantly, member firms look to the primary vendor to perform their obligations under the relevant contracts, which obligations would not be excused if the vendor chooses to use a sub-vendor. We also note that in many cases the functions performed by a sub-vendor will be ministerial, and therefore, should be entitled to the same exemption as is available under the Proposed Rule for third-party providers performing ministerial functions. Accordingly, the Committee believes that Rule 3190 should exclude sub-vendors from the ongoing due diligence requirement. Alternatively, third-party service providers should be permitted to certify that all of the functions performed by a sub-vendor are ministerial if that is in fact the case. Adopting a different standard would impose significant costs on member firms without any correlative benefits.

The Committee also notes that the language of paragraph (e) of Proposed Rule 3190 is inconsistent with the requirements of 3190(b). Paragraph (e) requires clearing and carrying firms to disclose certain information to FINRA about sub-vendors "if known." This requirement should be contrasted with the requirement found in paragraph (b), which requires all firms to conduct ongoing due diligence with respect to all sub-vendors, without any acknowledgment that the existence of a sub-vendor relationship may not be known to a firm. The Committee requests

[5] NTM 05-48 at Discussion Section I.

that FINRA amend the due diligence requirements as applied to sub-vendors so that they are consistent throughout the Proposed Rule.

Requirements Applying to Clearing or Carrying Members

Proposal. Proposed Rule 3190(c) would require a clearing or carrying member firm to vest an associated person of the firm with authority and responsibility for the following activities: (1) the movement of customer or proprietary cash or securities; (2) the preparation of net capital or reserve formula computations; and (3) the adoption or execution of compliance or risk management systems. In addition, Proposed Rule 3190(a)(3) would require the clearing or carrying member firm to vest authority and responsibility for any functions related to these activities that require registration and qualification under FINRA rules with an associated person of the firm who has the necessary registrations and qualifications.

Comments. First, the Committee requests that member firms designated "clearing and carrying members" under FINRA rules solely due to the impracticalities of complying with the "noon of the next business day standard" and which firms forward customer funds and securities to a clearing firm, be exempted from Rule 3190(c). These firms are not functioning in the traditional sense of a clearing or carrying firm. Designation as a carrying or clearing firm under FINRA rules should not result in a "one size fits all approach" under all FINRA rules. As the staff knows, some firms that are designated clearing and clearing firms under FINRA Rule 4110 are limited purpose broker-dealers and have this designation only because checks made payable to the broker-dealers' clearing firms cannot with 100 percent certainty be delivered to the clearing firm within 24 hours of receipt. These firms do not present the risks that Rule 3190 is intended to address, and therefore, should not come within the scope of paragraphs (c) - (e) of the Proposed Rule.

Second, with respect to a member firm's compliance and risk management systems, the Committee believes that it is simply not possible for member firms to "independently determine" that such systems provided to the member firm by third-party service providers achieve compliance with applicable securities laws and FINRA and MSRB rules. We note that the rule text does not contain this requirement but the text of the notice does: it states that member firms must (i) adopt such services and systems in a manner consistent with the regulatory requirements as they apply in light of the firm's size, businesses and business model; (ii) retain control over their implementation and use within the firm, and (iii) independently determine that they achieve compliance with applicable securities laws and FINRA and MSRB rules. The requirements of (i) and (ii) appear to be consistent with current business practice but (iii) would create a standard that member firms could not meet. Member firms do not design compliance or risk management systems purchased or leased from vendors and are not responsible as a matter of contract for the hardware or software that comprise such systems. Member firms must rely on vendor representations that the systems will perform as advertised. Members can and do monitor the performance of third-party systems, but they cannot independently determine the accuracy of the code specifications on which such systems are based. Accordingly, the Committee requests that FINRA strike this requirement from the text of the notice. Alternatively, FINRA could confirm that software purchased from a third party is not "outsourcing."

Third, the Committee requests that FINRA clarify that the scope of 3190(c)(3) is limited to systems that are **unique** to a clearing or carrying firm. Specifically, FINRA should define the types of compliance or risk management systems subject to the heightened obligations of the Proposed Rule as those that relate to a carrying or clearing firm's responsibilities for handling customer funds and securities, as contrasted with compliance and risk management systems that can be used by any member firm - for example, email retention systems. This clarification in the scope of Proposed Rule 3190(c)(3) would distinguish FINRA's goals in addressing potential systemic harms that may result from a clearing and carrying member's non-compliance with the securities laws as they relate to the handling of customer funds and securities from the general member firm outsourcing activities. Tailoring the breadth of paragraph (c)(3) of the Proposed Rule would further the purpose of the Proposed Rule without prescribing unnecessary compliance and supervisory obligations for activities that FINRA has determined do not warrant heightened oversight in the context of this rule.

Proposal. Proposed Rule 3190(d) would require that a clearing or carrying member firm include supervisory procedures that would require the firm to approve any transfer of duties by a third-party service provider to a sub-vendor.

Comments. The Committee strongly believes that clearing or carrying members should not be required to approve any transfer of duties by a third-party service provider to a sub-vendor. As explained earlier in this letter, it is impractical for member firms to know in advance of every instance in which a vendor may elect to use a sub-vendor. In addition, practically speaking, it is likely that in many instances the activities performed by a sub-vendor would qualify for the ministerial exception. Accordingly, the Committee believes that paragraph (d)(2)(2) should be deleted from the rule. Alternatively, member firms should be permitted to rely on third-party service provider certifications that all functions outsourced to a sub-vendor are ministerial if that is the case, and thus exempt from the Proposed Rule.

Proposal. Proposed Rule 3190(f)(2) would provide an exception to the Rule by not restricting activities performed pursuant to a carrying agreement approved under FINRA Rule 4311.

Comments. The Committee requests clarification regarding the meaning of paragraph (f)(2) of Proposed Rule 3190, which states that the provisions of the rule shall not "restrict" activities performed pursuant to a carrying/clearing firm agreement approved by FINRA under FINRA Rule 4311. As proposed, Proposed Rule 3190 does not explicitly address the interplay between it and FINRA Rule 4311, which will lead to confusion about which Rule governs these types of agreements. For instance, does paragraph (f) of Proposed Rule 3190 supersede the requirements of paragraph (e) of the Proposed Rule, which requires clearing and carrying members to provide notice to FINRA within 30 calendar days of entering into an outsourcing agreement? To avoid confusion and poor implementation of the Rules, the Committee requests FINRA to coordinate its regulatory approach to carrying agreements under FINRA Rules 3190 and 4311.

Posting to Books and Records

Proposal. As noted above, Proposed Rule 3190(c) would restrict clearing and carrying member firms from outsourcing the movement of customer or proprietary cash or securities, the preparation of net capital or reserve formula computations, and the adoption or execution of compliance or risk management systems to a person other than an associated person of the member firm. Further, Supplementary Material .02 of the Proposed Rule clarifies the restriction on the movement of customer or proprietary cash or securities by allowing a designated third-party service provider (including any sub-vendor) to post items to a member's books or records, provided the member reviews each posting prior to the close of the business day following the posting.

Comments. The Committee requests clarification that neither the text of the Proposed Rule nor Supplementary Material .02 requires daily posting to a member firm's books and records. In other words, member firms should be permitted to maintain current practices pursuant to which certain items, including commissions and dividends, are not posted to a member's books and records until the end of the month or the end of a quarter as required by the member firm's operational procedures.

CONCLUSION

The Committee appreciates the opportunity to comment on the Proposed Rule. Please do not hesitate to contact Cliff Kirsch (212.389.5052) or Holly H. Smith (202.383.0245) if you have any questions on the issues addressed in this letter.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: Holly H. Smith

BY: Cliff E. Kirsch by HS

FOR THE COMMITTEE OF ANNUITY INSURERS

Appendix A

THE COMMITTEE OF ANNUITY INSURERS

AEGON Group of Companies
Allstate Financial
AVIVA USA Corporation
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
CNO Financial Group, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
John Hancock Life Insurance Company (USA)
Life Insurance Company of the Southwest
Lincoln Financial Group
Massachusetts Mutual Life Insurance Company
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
RiverSource Life Insurance Company
(an Ameriprise Financial company)
SunAmerica Financial Group
Sun Life Financial
Symetra Financial
The Phoenix Life Insurance Company
TIAA-CREF
USAA Life Insurance Company