# CURTIS BROKER-DEALER CLIENT ALERT

## SEC APPROVES FINRA RULE GOVERNING DEFERRED VARIABLE ANNUITY TRANSACTIONS

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On September 7, 2007, the Securities and Exchange Commission announced its approval of a proposed new Financial Industry Regulatory Authority ("FINRA") rule intended to curb abusive sales practices relating to the purchases and exchanges of deferred variable annuities. Rule 2821, the effective date of which has not yet been announced, has four primary components.

First, the rule imposes a suitability requirement in connection with recommendations of deferred variable annuity transactions. In order to recommend the purchase or exchange of a particular deferred variable annuity, a FINRA member must have a reasonable basis to believe that (a) the customer has been generally informed of the various features of the deferred variable annuity, (b) the customer would benefit from certain features of the deferred variable annuity (such as tax deferred growth or annuitization), and (c) the deferred variable annuity is suitable for the customer based on the customer's age, income, financial situation and needs, and investment experience and objectives, among other factors. In connection with recommended exchanges of deferred variable annuities, a member must also consider whether the customer would incur a surrender charge or be subject to increased fees, lose existing benefits, or benefit from product enhancements, as well as whether the customer's account has been subject to another deferred variable annuity exchange within the preceding three years.

Second, the rule mandates principal review and approval of any transactions involving deferred variable annuities. Under the rule, a principal may approve a transaction only if he or she has determined that there is a reasonable basis to believe that it would be suitable for the customer based on the factors discussed above. A principal must document his or her determinations regarding a recommended transaction, regardless of whether the principal approves or rejects the transaction.

Third, the rule requires member firms to establish and maintain supervisory procedures aimed at ensuring compliance with the rule. In particular, members are required to implement surveillance procedures to determine if any of their registered representatives have rates of recommending deferred variable annuity exchanges sufficiently high to suggest conduct inconsistent with the applicable provisions of Rule 2821, other relevant FINRA rules, or the federal securities laws. In addition, members must put into place policies and procedures designed to implement corrective actions in response to inappropriate exchanges.

Fourth, the rule requires member firms to implement training programs designed to educate their registered representatives and principals on deferred variable annuities and the requirements of the rule.

The Commission solicited comments prior to approving Rule 2821. Some commenters asserted that the rule would impose undue economic and competitive burdens upon member firms. Others suggested that the rule's requirements would needlessly place a "red flag" on deferred variable annuities, thereby dissuading investment therein. The National Association of Securities Dealers, Inc., which was authorized by the Commission to change its name to FINRA on July 26, 2007, responded by stating that the proposed rule was consistent with, and promoted the goals of, the Securities Exchange Act of 1934. The Commission concluded that the NASD appropriately considered the costs and benefits of the rule as it was developed and modified.

In its order approving Rule 2821, the Commission noted that the rule is intended to supplement, not replace, FINRA's other rules relating to suitability, review, supervision, and training. The Commission's order is available at *http://www.sec.gov/rules/sro/nasd/2007/34-56375.pdf*.

The Commission also issued an exemptive order allowing FINRA members to hold customer funds for up to seven business days while completing the principal review mandated by Rule 2821 without becoming fully subject to, and without being required to maintain higher levels of net capital in accordance with, Rule 15c3 of the Exchange Act. The exemptive order is available at *http://www.sec.gov/rules/exorders/2007/34-56376.pdf*.

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