NSCP
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VIA ELECTRONIC MAIL

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
(pubcom@finra.org)

Re: FINRA Requests Comment on the Effectiveness and Efficiency of Its Rules on Outside Business Activities and Private Securities Transactions

Dear Ms. Mitchell:

The National Society of Compliance Professionals ("NSCP") submits this letter in response to the Financial Industry Regulatory Authority, Inc.'s ("FINRA") request for comments on the effectiveness and efficiency of its rules on outside business activities and private securities transactions. NSCP is a nonprofit, membership organization with approximately 2,000 members and is dedicated to serving and supporting the compliance professional in the financial services industry in both the U.S. and Canada. To our knowledge, NSCP is the largest organization of securities industry professionals in the United States and Canada devoted exclusively to compliance. In light of NSCP's focus on compliance and compliance professionals, our comments will be limited to concerns that impact compliance programs and/or compliance professionals.

NSCP begins its comments by commending FINRA for undertaking a retroactive review of the above referenced rules and, more generally, for the steps that FINRA has taken of late to engage with its members, including through FINRA's Member Relations and Education Department, and to provide education and compliance resources.

NSCP's responses to particular questions posed by FINRA's Regulatory Notice 17-20 follow. For convenience, we have set forth the particular questions to which we are responding under their subject matter headings.

***Request for Comment**:*

FINRA has identified Rules 3270 (Outside Business Activities of Registered Persons) and 3280 (Private Securities Transactions of an Associated Person) for review. The rules govern firm employees' business and securities activities carried out away from their firm — activities that are outside the regular course or scope of their employment with the firm. The ability of firm personnel to engage in such activities may benefit some investors, depending on the circumstances, but may also pose risks, including to both investors and the firm. The rules seek to protect the investing

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public from potentially problematic or risky activities that are unknown to the firm but could be perceived by the investing public as either part of the firm's business or having the firm's imprimatur. The rules seek to protect the firm from the concomitant reputational and litigation risks. In keeping with these purposes, the rules provide a regulatory framework for firms to be informed of such activities, implement a system to assess them, determine whether to limit or place conditions on the employee's participation in them and, in the case of private securities transactions for compensation, record and supervise the transactions.

FINRA seeks answers to the following questions with respect to these rules:

1. Have the rules effectively addressed the problem(s) they were intended to mitigate? To what extent have the original purposes of and need for the rules been affected by subsequent changes to the markets, the delivery of financial services, the applicable regulatory framework, or other considerations? Are there alternative ways to achieve the goals of the rules that should be considered?

NSCP believes FINRA Rules 3270 and 3280 have not effectively addressed the problems they were intended to mitigate. In general, this reflects a failure by covered persons to comply with the notification requirements. We believe this failure often stems from confusion and misunderstandings about the scope of what is required by these rules. Accordingly, simplification of the rules would likely increase compliance while also lessening the burden on compliance personnel. Of course, as with any rules that depend upon self-reporting, FINRA Rules 3270 and 3280 are largely ineffective against bad actors, that is, covered persons who choose not to comply with their reporting obligations. We do not believe, however, that it is economically feasible to require firms to verify whether covered persons are complying with the reporting requirements. For this reason, we believe that the rules should clearly state that the obligation to report lies with the covered person and that, in the absence of red flags, the member firm has no obligation to independently identify reporting failures.

As to the impact on the rules as a result of changes in the brokerage business, in the many years since these rules were adopted, member firms have grown increasingly diverse in their business models and the services they provide. As a result, the one size fits all approach of FINRA Rule 3270 (Outside Business Activities of Registered Persons), which seeks to cover all non-passive, outside business activities, has increasingly become overly broad. Simply put, the conflicts from outside employment faced by a member firm that has a proprietary only business, i.e., one that does not have any customers, are going to be very different from those faced by a traditional, retail oriented shop. Similarly, institutional firms will face challenges that are different still.

Another change in the industry is the proliferation of registered representatives who engage in securities activities as well as advisory, banking and/or insurance activities. While these activities are frequently performed for affiliated entities, they are sometimes performed across unrelated entities. We do not think these rules offer a good fit for these "dual hatted" representatives.

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With respect to FINRA Rule 3270 (Outside Business Activities of Registered Persons), we believe FINRA should consider revising the rule to give member firms the authority to make category-based exemptions for their registered persons based upon the member firm's business model. It seems clear that an almost endless variety of non-financial second jobs do not raise conflict or supervisory concerns that warrant the time and trouble of notice and review. By way of example, this might include working in restaurants or stores or driving for Uber. Under the current rule, registered persons have to report these jobs to their member firms, which then have to document their review and approval. Reporting, review and approval of these types of jobs can be a substantial effort that takes time away from more important compliance obligations. Member firms should have the authority to exclude these and other employment categories that are unrelated to financial or investment products from the notice and approval requirements. Alternatively, FINRA could amend the rule to limit its scope to employment that involves financial or investment products and rely upon member firms to impose stricter requirements if they thought it in their, or their customer's, interest to do so.

It would also be helpful if FINRA Rule 3270 (Outside Business Activities of Registered Persons) and Question 13 of Form U4 ("Question 13") were conformed, as currently, responses under Rule 3270 and Question 13 can produce inconsistent responses. Additionally, FINRA could provide guidance as to the scope of Question 13 that might bring it more in line with Rule 3270. For example, while a passive investment, *e.g.*, investment as a limited partner, would seem to fall outside of Rule 3270, it is less clear whether it might be within the scope of Question 13. It would be helpful to provide clarification that Question 13 should be interpreted to exclude passive investments (notwithstanding the investment may make someone a limited partner, member or the like). Additionally, Question 13 excludes non-investment related activity that is exclusively charitable, civic, religious or fraternal so long as it is recognized as tax exempt. Consideration should be given to a similar exclusion with respect to FINRA Rule 3270.

With respect to FINRA Rule 3280 (Private Securities Transactions of an Associated Person), while we are generally in agreement with the rule's current reporting obligation, we have concerns about the approval and supervisory requirements set forth at Subsection (c) of the rule.

There seems to be widespread confusion in the industry as to what obligations are imposed upon member firms as a result of the requirement in Subsection (c)(2) that the member shall record the transaction on its books and records and supervise the individual's participation in the transaction. We believe it would be in keeping with the purpose of the rule to substitute a requirement that the counterparty on the transaction acknowledge in writing that the associated person is not acting on behalf of, or in his or her capacity as an employee of, the member firm. Such an approach would seem consistent with the purpose of the rule, which, as stated by FINRA in Regulatory Notice 17-20, seeks "to protect the investing public from potentially problematic or risky activities that are unknown to the firm but could be perceived by the investing public as either part of the firm's

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business or having the firm's imprimatur. The rules seek to protect the firm from the concomitant reputational and litigation risks." We believe that receipt of a written acknowledgement by the counterparty would achieve both of these objectives in a far simpler manner than the rule's current supervisory obligations, which actually seem designed to interject the member firm into the middle of the transaction and, thereby, spread confusion as to the firm's exact role. In other words, the rule's supervisory obligations seem at cross purposes with the stated purpose of the rule.

Moreover, where the outside securities transaction is performed for a regulated entity, e.g., an investment adviser or an insurance company, we believe that the member firm should be able to rely upon the supervisory obligation of the regulated entity and not be called upon, in effect, to supervise that entity's supervision. Accordingly, in that situation, we believe that the member firm should not have a supervisory obligation notwithstanding the lack of a written acknowledgment from the counterparty as it should be the obligation of each regulated entity to ensure that there is no confusion among its customers as to which entity the customer is dealing with. Of course, under FINRA Rule 3270 (Outside Business Activities of Registered Persons), the member firm would always have the right to prohibit or impose conditions and limitations on such activities.

In addition, Subsection (c)(2), or FINRA guidance thereon, should make it clear that, absent red flags, a firm can have no supervisory obligation with respect to a private securities transaction that was explicitly prohibited by the firm. Typically, it is not practical or reasonable for firms to independently verify whether an associated person is complying with a prohibition. Accordingly, firms should not be put to the trouble and expenses of trying to independently verify whether an associated person is complying with any prohibition. Making this point clear in the rule or in guidance would help protect firms from adverse regulatory findings as well as possible claims from counterparties on private securities transactions, which claims can result in significant costs while also having an adverse impact on the cost of insurance.

The above changes would also allow simplification of Subsection (c)(1). Specifically, basing the obligation of the member firm to approve the representative's participation in the transaction on whether the associated person receives "selling compensation" seems a needless complication that introduces a determination that can be factually and legally complex. Absent the supervisory obligations set forth in Subsection (c)(2), it seems there would be little reason to make this distinction and, therefore, that it would be easier, and more in keeping with the rule's purpose, to treat all transactions in the same manner regardless of whether selling compensation is present.

2. What have been experiences with implementation of the rule set, including any ambiguities in the rules or challenges to comply with them?

Insofar as Rule 3270 (Outside Business Activities of Registered Persons) is concerned, we believe that there is a great deal of confusion as to the scope of Supplementary Material .01 (Obligations of Member Receiving Notice). On its face, Supplementary Material .01 imposes an obligation on

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members to evaluate a noticed activity for conflicts and determine whether conditions or limitations should be imposed. It appears, however, that examiners from both FINRA, various states and the SEC, interpret this language as creating an affirmative obligation to supervise whether the representative is actually complying with the imposed conditions and limitations. Often times, activities that, by definition, occur away from the firm, are difficult, if not impossible, to supervise. Indeed, perversely, the effect of such a supervisory obligation is to discourage the imposition of reasonable conditions and limitations least the firm then be obligated to supervise them. At a minimum, the scope of any supervisory obligation under Rule 3270 should be clarified.

With respect to FINRA Rule 3280 (Private Securities Transactions of an Associated Person), as discussed above, we believe there is a great deal of confusion among members and regulators as to the scope of the requirements in Subsection (c)(2) that the member shall record the transaction on its books and records and supervise the individual's participation in the transaction. As stated above, we believe these requirements can and should be eliminated and, if not eliminated, then, at a minimum, these obligations should also be clarified.

Our members have also found that the presence of offshore associated persons can raise difficult privacy and foreign law issues under either rule particularly with respect to supervision. For example, local law may not permit review of an employee's work email or allow an employer to request information regarding an employee's charitable or social activities. Accordingly, application of these rules to offshore employees can be particularly challenging.

3. What have been the economic impacts, including costs and benefits, arising from FINRA's rules? Have the economic impacts been in line with expectations described in the rulemaking? To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models?

As discussed above, we believe that Rule 3270 (Outside Business Activities of Registered Persons) is overly broad in that it does not distinguish between activities that pose little risk from those that do. As a result, Rule 3270 imposes significant but unnecessary costs on members. Moreover, the unnecessary complexity of both rules also imposes significant training related costs as well as costs related to non-compliance.

In addition, costs associated with these rules seem to be escalating as FINRA and other regulators use these rules as justification for imposing supervisory obligations on member firms. These supervisory obligations are often ill defined, difficult to comply with and frequently require customization, all of which lead to escalating costs. Also, the supervisory obligations under Rule 3280 (Private Securities Transactions of an Associated Person) are frequently duplicative of other regulated entities and, therefore, provide little if any additional benefit. In addition, the open-ended supervisory obligation under Rule 3280 (Private Securities Transactions of an Associated Person) exposes firms to possible liability to counterparties on private securities transactions. This results in increased insurance liabilities as well as costs of defending and settling such actions. This is

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true even when the firm prohibited the transaction and, therefore, did not believe that there was anything to supervise.

4. Can FINRA make the rules, interpretations or attendant administrative processes more efficient and effective?

In addition to the amendments to these rules discussed above, published guidance, including on the issues discussed above, would be helpful both in terms of firms understanding their obligations and in terms of regulators being more uniform in their review of compliance with these rules. More generally, examination and enforcement findings relating to these (and other) rules should be published with sufficient detail so that firms can better understand FINRA's expectations. Currently, examination findings are rarely published and enforcement decisions are usually so vague in their coverage of the facts as to be of little use.

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We commend FINRA for giving us this opportunity to present our views on how FINRA should engage its members and other stakeholders. NSCP would welcome the opportunity to answer any follow-up questions that FINRA may have on this submission or to provide such further assistance as FINRA may request.

Thank you for your attention to these comments. Questions regarding the foregoing should be directed to the undersigned at (860) 672-0843.

Sincerely,

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