



June 29, 2017

By Electronic Mail to [pubcom@finra.org](mailto:pubcom@finra.org).

Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

**Re: FINRA Regulatory Notice 17-20:  
SIFMA Comment on the Effectiveness and Efficiency of FINRA's Rules on  
Outside Business Activities and Private Securities Transactions**

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association ("SIFMA")<sup>1</sup> appreciates the opportunity to respond to the request for comment issued by the Financial Industry Regulatory Authority ("FINRA") in Regulatory Notice 17-20 ("RN 17-20")<sup>2</sup> regarding FINRA Rules 3270 and 3280, which govern outside business activities ("OBAs") and private security transactions ("PSTs"), respectively.

#### **I. EXECUTIVE SUMMARY**

SIFMA supports FINRA's effort to retrospectively review the effectiveness and efficiency of FINRA Rules 3270 and 3280. SIFMA believes that this process should balance the need to identify outdated and inefficient rules with concerns about investor protection. SIFMA appreciates FINRA's efforts to incorporate comments, including input provided by some of our member firms, regarding how the rules can best meet their investor-protection objectives through reasonably efficient means. Without detracting from the support stated herein, our comments on RN 17-20 highlight various issues that

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<sup>1</sup> SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$18.5 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>2</sup> [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-17-20.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-20.pdf).

warrant consideration by FINRA during its retrospective review of the rules governing OBAs and PSTs.

Specifically, SIFMA believes that FINRA can best further its efforts with respect to Rules 3270 and 3280 by:

- clarifying which OBAs are covered by Rule 3270;
- providing specific exemptions for certain activities that would otherwise be covered under Rule 3270;
- adopting risk-based rules that target problematic OBAs and PSTs over low-risk activities and transactions; and
- eliminating ambiguities in Rules 3270 and 3280 that cause an excess of compliance cost with little benefit to the investing public.

SIFMA's comments are further discussed in the various sections of this comment letter.

## **II. COMMENTS RELATED TO FINRA RULE 3270**

### **A. General Comments**

Rule 3270 requires registered persons to provide prior written notice to a member firm before conducting an OBA. OBAs are defined broadly and include activities that are for compensation, not for compensation, or carry a reasonable expectation of compensation. Member firms receiving notice from a registered person must evaluate the proposed activity to determine whether it will interfere with the registered person's responsibilities to the member firm, the member firm's customers, or whether the investing public would consider it part of the member firm's business. A member firm must then consider whether to impose conditions on the registered person's activities or prohibit the activity.

**B. Specific Issues**

- 1. Has the rule effectively addressed the problem(s) it was intended to mitigate? To what extent have the original purposes and need for the rule 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 rule that should be considered?***

Rule 3270 addresses OBAs in a broad and ambiguous fashion that includes activities that exceed the rule's original intent.<sup>3</sup> The OBA rule remains a frequent subject of FINRA disciplinary proceedings.<sup>4</sup> These activities may include work for charitable and local organizations, including serving on the board of a homeowners' association or on the board of a local recreational youth league. Moreover, the emergence of the "gig" economy has drastically changed the variety and type of OBAs available to a registered person. For example, technology has facilitated short term property rentals, sales of goods, short term employment, and the raising of charitable donations. As a result of Rule 3270's broad language and ambiguities, the rule is unable to effectively serve its purpose because member firms must disclose a large number of low-risk items that create "white noise," distracting time and money from investigating high-risk items.

Section 4 below describes several ways for FINRA to change Rule 3270 to more accurately reflect the rule's original purpose.

FINRA could add to Rule 3270 the instruction from Section 13 of Form U4, which excludes "non-investment related activity that is exclusively charitable, civic, religious or fraternal and is recognized as exempt."<sup>5</sup> FINRA could also provide a more specific definition for "business activity" and "compensation" to Rule 3270 that would make it clear which activities and arrangements are included within the scope of the rule.

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<sup>3</sup> The National Association of Securities Dealers (NASD) originally promulgated Rule 3270 in 1988 to address the large number of disciplinary cases that it believed could have been avoided had an associated person disclosed its outside activities to the member firm. See NASD Request for Comments on Proposed NASD Rule of Fair Practice Regarding Outside Business Activities 88-5 (*available at [http://finra.complinet.com/en/display/display.html?rbid=2403&element\\_id=957](http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=957)*). The NASD was concerned that the financial securities industry had become increasingly diverse, providing increased outside business opportunities for associated persons and a greater potential for problems. The trend that NASD noticed in 1988 has not abated; today registered persons can engage in an even more diverse array of OBAs than thirty years ago, aided by the development of technology.

<sup>4</sup> See, e.g., Disciplinary and Other FINRA Actions, May 2017 (*available at [http://www.finra.org/sites/default/files/publication\\_file/May\\_2017\\_Disiplinary\\_Actions.pdf](http://www.finra.org/sites/default/files/publication_file/May_2017_Disiplinary_Actions.pdf)*).

<sup>5</sup> FINRA Form U4, Section 13 (*available at <https://www.finra.org/file/form-u4>*).

Alternatively, FINRA could create a list of risks that firms must address in screening OBAs and allow firms to conduct their own assessments of what types of positions should be disclosed.

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

Implementing Rule 3270 has proven difficult because the definitions of “business activity” and “compensation” are overly broad. Employees often do not realize that certain activities, such as working for a charitable organization, are considered OBAs. As a result, member firms spend significant amounts of time tracking down staff concerning these positions or determining the activities for which compensation has or will be received, wasting resources investigating activities that pose little risk for the investing public or the firm. In addition, Rule 3270 provides minimal guidance on the level and extent of supervision expected after a firm has approved an OBA.

Certain activities have proven particularly problematic in determining whether disclosure is necessary because of their ambiguous nature. For example, ownership of a domain name, infrequent rental of all or part of real property, serving on the investment committee of a non-profit, serving on a committee set up for a one-time fundraising event, crowdfunding, serving on the board of an affiliated entity, and holding property through an LLC, have all emerged as areas in which clarity is greatly needed.

In addition, we note that Rule 3270 and Rule 3280 are not always mutually exclusive in that under certain conditions, some activities would require disclosure both as an OBA and a PST, which could cause confusion for employees. For example, if an associated person creates an LLC with two other people, the investment itself may be a PST and the role of the associated person may also be an OBA. This problem could be eliminated by allowing for a combined disclosure in such circumstances.

***3. What have been the economic impacts, including costs and benefits, arising from the rule? How 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?***

The ambiguities in Rule 3270 have resulted in considerable and increasing expense to member firms as the number and types of OBAs proliferate. Member firms expend significant resources to monitor and maintain controls and investigate potential failures to disclose. Often these OBAs do not present conflicts of interest with the firm’s brokerage activities. As a result, the costs of internal notice, review, and approvals, as

well as delivering the corresponding disclosures of information on Form U4 are not currently yielding commensurate benefits with respect to investor protections.

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

SIFMA recognizes the importance of requiring member firms to disclose certain OBAs and recommends several changes to Rule 3270 that would make the rule more effectively serve its original purpose:

- FINRA should add more concrete definitions of “business activity” and “compensation” which would help firms evaluate OBAs.
- FINRA should provide guidance on the level and type of supervision expected after a member firm has approved an OBA.
- FINRA should take an approach that specifically targets the risky OBAs that the rule was intended to mitigate by:
  - highlighting the types of positions that should be excluded from the disclosure requirements or providing a list of the types of risks on which FINRA would like the firms to focus;
  - publishing a list of frequently asked questions;
  - importing the language from Section 13 of Form U4 that specifically excludes “non-investment related activity that is exclusively charitable, civic, religious or fraternal;”<sup>6</sup>
  - providing details about related exam deficiencies; and
  - adding Supplementary Material to Rule 3270 reinforcing that firms can use a risk-based approach to monitoring and reviewing OBAs to ensure that the activity does not become PST activity or otherwise create conflicts of interest.
- FINRA should clarify what is reportable on Form U4, such as providing that the disclosure of OBAs under Section 12 of Form U4 is not required if disclosure is made under Section 13 of Form U4.
- Alternatively, FINRA could create a *de minimis* exception for certain non-securities transaction related OBAs, such as passive income from rental property. Adopting such a standard would eliminate many of the low-risk OBAs and would allow member firms to focus on higher risk OBAs.

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<sup>6</sup> FINRA Form U4, Section 13 (available at <https://www.finra.org/file/form-u4>).

FINRA could also adopt a more principles-based approach to Rule 3270 under which certain activities would be expressly excluded and the notice requirements would only be required when potential conflicts of interest are present.

SIFMA notes that FINRA should clarify its position with regards to dual employees or “multi-hatted” arrangements. First, FINRA should revisit the issue from Notice 08-24 concerning dual bank-brokerage employees and clarify whether the broker dealer must supervise permitted bank securities activities as either OBAs or PSTs. Second, FINRA should clarify the level of supervision broker dealers must conduct over dual broker dealer investment adviser (“IA”) employees. The existing guidance is over twenty years old and clarification is needed (Notice to Members 94-44 and 96-33).<sup>7</sup> We do not believe multi-hatted arrangements such as having multiple registrations with other affiliated broker-dealers, investment advisers or insurance companies, or being registered with one affiliate and being paid by another affiliate, should need to be disclosed as OBA(s) including on FormU4. Given the evolving nature of the advisory business and enhancement of regulatory and compliance oversight in the advisory space, clarification of FINRA’s expectations in this area is important to ensure efficient and effective investor protection without overburdening the industry with duplicative regulatory and compliance coverage.

Lastly, other self-regulatory organizations have rules that cover outside business arrangements.<sup>8</sup> To avoid inconsistency, FINRA should coordinate and harmonize its rulemaking with other regulatory organizations.

### **III. COMMENTS RELATED TO FINRA RULE 3280**

Rule 3280 prohibits an associated person from participating in any manner in a PST except in accordance with Rule 3280.<sup>9</sup> Specifically, the Rule requires that, prior to participating in any PST, an associated person shall provide written notice to the member with which he or she is associated.

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<sup>7</sup> See NASD Notice 94-44, Board Approves Clarification on Applicability of Article III, Section 40 of Rules of Fair Practice to Investment Advisory Activities of Registered Representatives, 1994, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=1489](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1489); NASD Notice to Members 96-33, NASD Clarifies Rules Governing RR/IAs, May 1996, available at <http://www.finra.org/sites/default/files/NoticeDocument/p013792.pdf> (“NtM 96-33”).

<sup>8</sup> See, e.g., CBOE Rule 9.4.

<sup>9</sup> NASD proposed what is now FINRA Rule 3280 in 1975 due to concerns that members’ PSTs could deprive the public of investor protection. In adopting the Rule, NASD sought to eliminate presumably high-risk PSTs conducted without supervisory accountability.

**A. General Comments**

SIFMA believes that Rule 3280 would benefit from further clarification, as further discussed below. Enhanced clarity would greatly assist compliance functions of member firms in the overall efforts to efficiently address adherence to the rule.

**B. Specific Questions from FINRA**

- 1. Has the rule effectively addressed the problem(s) it was intended to mitigate? To what extent have the original purposes and need for the rule 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 rule that should be considered?***

SIFMA is concerned that, like Rule 3270, Rule 3280's definitions are overly broad. As a result, low-risk PSTs are over-disclosed, creating a "white noise" effect that distracts both our industry and FINRA from devoting time and attention to high-risk PSTs. Ultimately, the large volume of low-risk items diminishes our industry's capacity to focus on and discover PST disclosures that may present a higher level of risk.

For example, Rule 3280 does not clearly define "securities transaction," "selling compensation," or "person associated with a member," leading to the disclosure of all types of transactions not executed on the open market. For example, "person associated with a member" could be interpreted broadly to include a spouse or other relatives. In addition, the case law defining "security" is vast and complex and, out of an abundance of caution, many firms require the disclosure of transactions involving items that are not considered securities under the Securities Act of 1933 (e.g., loans). If Rule 3280's primary aim is to ensure that associated persons do not receive selling compensation, then the rule should more clearly outline the considered factors in allowing PSTs where selling compensation is not present and the persons to whom the rule applies.

In addition, Rule 3280 appears to cover "selling away" activity or business conducted away from a representative's employer broker-dealer. Rule 3280 also appears to include personal investments in private placements subject to exclusions. Personal investments in private placements for start-up small businesses, venture capital offerings or hedge funds are very different activities when compared to conducting securities-related business with customers away from an employer member firm. These distinctions and activities could be addressed in clearer, separate provisions of the rule.

FINRA could achieve the original goals of Rule 3280 by re-drafting the rule to clearly identify and distinguish the transactions intended to be covered. This could be achieved by clearly expressing the risks that the member needs to mitigate.

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

As noted in Section II.B.2, SIFMA is particularly concerned about activities that have components of both OBAs and PSTs. For example, if an associated person is creating an LLC with two other people, the investment may be a PST and the Member/Manager/Partner role in the LLC may be an OBA. Thus, two disclosures are required. For such events, FINRA should consider allowing a combined disclosure. This would allow firms to save time and resources spent on determining if an item is an OBA, PST or both.

The determination of the types of conflicts or “red flags” when reviewing written requests of a registered representative poses difficult compliance challenges. FINRA could provide guidance to help member firms more effectively evaluate such written requests.

***3. What have been the economic impacts, including costs and benefits, arising from the rule? How 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?***

Because Rule 3280 is ambiguous, firms must have more resources available to monitor and maintain compliance controls, as well as to investigate potential failure to disclose transactions and issue discipline.

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

FINRA can make the rule processes more effective by clarifying the transactions that should be excluded from disclosure requirements, as well as highlighting the types of risks firms should focus on and the specific persons to whom the rule applies. This could be achieved by providing clearer definitions of “securities transaction,” “selling compensation,” and “person associated with a member.” Such clarification would allow firms to be able to robustly monitor transactions having the highest potential for reputational risk.

Specifically, FINRA should clarify supervisory obligations with respect to discretionary brokerage accounts or investment advisory accounts held with other executing broker-dealers and custodians away from an associated person's employer firm. More information regarding employer firm and executing firm obligations related to outside accounts controlled by an associated person, such as managed or discretionary accounts, where the associated person has control but does not have a beneficial interest, would be helpful to our industry. These accounts are not covered under FINRA Rule 3210 but were viewed as covered under NASD Rule 3050 and have also been viewed as covered under Rule 3280 or more general supervisory requirements. For example, FINRA should clarify whether an employer firm is required to supervise those outside discretionary or managed accounts and transactions controlled by its associated persons by requesting duplicate confirms and statements or the equivalent information. FINRA also should clarify whether an executing member is required to transmit account confirmations and statements or the equivalent upon an employer firm's request, and to what extent. Employer firms are continuing to broadly request this information even though the accounts are no longer covered under Rule 3210. Given the operational complexities that can be involved in requesting and delivering this information, the industry would benefit from additional clarification on employer firm and executing firm obligations with respect to requesting and transmitting this account information, scope of the accounts covered, and other considerations such as privacy obligations to the account owners.

Clarification of Notices 94-44 and 96-33 would be helpful. This guidance requires member firms to collect and record information about clients of the RIA firm that are not clients of the member firm. In addition to the administrative burden, the review and involvement of the broker-dealer firm in transactions of a separately regulated RIA firm can cause client confusion about roles and responsibilities of the broker-dealer firm vs. the RIA firm.

Furthermore, since the issuance of NtMs 94-44 and 96-33, the compliance and supervisory obligations of IA firms have been expanded and formalized. In 2003, the SEC adopted Rule 206(4)-7.<sup>10</sup> Under Rule 206(4)-7, each IA that is registered or required to be registered under the Advisers Act must establish an internal compliance program that addresses the IA's performance of its fiduciary and substantive obligations under the Investment Advisers Act of 1940 ("Advisers Act"). The rule dictates that each IA adopt and implement written policies and procedures reasonably designed to prevent the IA and its personnel from violating the Advisers Act, review those policies and procedures at

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<sup>10</sup> See Compliance Programs of Investment Advisers and Investment Companies; Investment Advisers Act Release No. 2204, Dec. 17, 2003 (adopting Advisers Act Rule 206(4)-7).

least annually, and designate a chief compliance officer. The result of those and other requirements under the Advisers Act is robust investor protections, supervisory requirements, and suitability obligations that apply to the investment advisory services and execution of securities transactions by IAs and their IARs. These rules implemented pursuant to the Advisers Act require that IA firms supervise issues and conduct similar to those covered by NtMs 94-44 and 96-33. Given the potential for duplicative regulatory oversight, potentially conflicting compliance oversight, investor confusion about roles and responsibilities, and associated costs, we think it would be helpful for FINRA to clarify the guidance in NtM 96-33.

SIFMA is convinced that our industry would benefit from doing away with the supervisory review process in connection with employee discretionary managed accounts (“managed accounts”) – so long as there are sufficient controls in place to protect against the risk of insider trading. The managed accounts review process is time consuming, increases the burdens placed on supervisors, and presents very limited upside protecting against the risk of insider trading. Minor changes to processes can potentially save time for supervisors who can then allocate their time to other, more meaningful, activities. In this regard, SIFMA notes that an adviser-signed certification would sufficiently serve to protect against potential insider trading so long as it contains the following statements:

1. The employee did not:
  - a. directly or indirectly influence particular purchases;
  - b. suggest purchasing or selling any securities; and/or
  - c. consult with the adviser regarding the portfolio’s asset allocation; and
2. The adviser:
  - a. was not directly or indirectly influenced by the employee to purchase, sell or trade any securities;
  - b. did not receive or act upon suggestions concerning purchases or sales of securities;
  - c. did not receive or act on a request from the employee concerning the allocation of assets in the employees accounts; and
  - d. shall inform the employee’s firm in writing if the employee attempts to influence the adviser’s choice of securities.

Lastly, other self-regulatory organizations have rules covering outside business activities and private securities transactions. To avoid inconsistency, FINRA should coordinate and harmonize its rulemaking with other regulatory organizations.

Ms. Jennifer Piorko Mitchell  
June 29, 2017  
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#### IV. CONCLUSION

SIFMA appreciates the opportunity to comment on the RN 17-20. We commend FINRA for its efforts towards ensuring that Rules 3270 and 3280 remain relevant and appropriately designed to achieve their objectives. We believe the comments included in this letter are consistent with FINRA's efforts to retrospectively review these rules to realize their regulatory effectiveness and efficiency. We look forward to a continuing dialogue with FINRA.

If you have any questions or would like additional information, please contact Kevin Zambrowicz, Managing Director & Associate General Counsel, SIFMA, at (202) 962-7386 ([kzambrowicz@sifma.org](mailto:kzambrowicz@sifma.org)), or our counsel, Marlon Paz, at 202-661-7178 ([paz@sewkis.com](mailto:paz@sewkis.com)).

Very truly yours,

A handwritten signature in black ink, appearing to read "K. Zambrowicz", is centered within a rectangular box.

Kevin Zambrowicz  
*Managing Director &  
Associate General Counsel*

cc: Evan Charkes, Co-Chair, SIFMA Compliance & Regulatory Policy Committee

Mary Beth Findlay, Co-Chair, SIFMA Compliance & Regulatory Policy Committee

Marlon Q. Paz, *Seward & Kissel LLP*