



PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

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June 29, 2017

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, DC 20006-1506
pubcom@finra.org

Re: FINRA Regulatory Notice 17-20 – Proposed Amendments to Rules Governing Communications with the Public

Dear Ms. Mitchell:

I write on behalf of the Public Investors Arbitration Bar Association (“PIABA”), an international bar association comprised of attorneys who represent investors in securities arbitration proceedings. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Financial Industry Regulatory Authority (hereinafter “FINRA”) related to investor protection.

FINRA Regulatory Notice 17-20 seeks comments concerning the effectiveness of FINRA Rules 3270 and 3280. FINRA Rules 3270 and 3280 impose requirements on registered representatives and broker-dealers for the reporting and supervision of outside business activities and private securities transactions carried out away from the firm. Specifically, under Rule 3270, a registered representative is required to give written notice to his FINRA member firm. Rule 3270’s supplementary material sets forth what the member firm must do once it received such written notice of an outside business activity. It is the member firms’ responsibility to review the outside business activities of their registered representatives and determine whether, and under what conditions (if any), to allow outside business activity to proceed. Further, the member firm must determine whether the activity is actually an outside securities activity (as opposed to merely a business activity) that is subject to the requirements of Rule 3280, which specifically applies to securities transactions. Rule 3280 requires that private securities transactions that take place away from the registered representative’s member firm be approved, recorded on the firm’s books and records, and supervised as if the transaction were executed on behalf of the member.

FINRA Rules 3270 and 3280 were designed to prevent unsupervised securities sales or fraudulent securities activities by registered representatives of member firms (*e.g.*, Ponzi schemes, promissory note

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sales, sales of unregistered securities, and other investment scams). Accordingly, proper implementation of and training on these rules by firms is crucial to preventing registered representatives from taking unfair advantage of the goodwill that they may have because they are licensed securities professionals. In fraudulent investment scams, registered representatives also often use the good reputation of their member firms to perpetrate frauds that they may not have otherwise been able to perpetrate. Thus, Rules 3270 and 3280, if they are properly implemented, can also offer member firms protection from liability and reputational damage by enabling the detection and prevention of some types of misconduct by their registered representatives. Moreover, under FINRA Rule 3010 and NTM 01-79, member firms are required to reasonably supervise and ensure compliance with the Rules 3270 and 3280.

Issues raised by the involvement of registered representatives in private securities transactions and improperly participating in an outside business activity away of a member firm have been the subject of NASD guidance since at least the mid-1980s. In NTM 86-65, the NASD noted that off-site representatives who operate both securities businesses and outside business activities were the most frequent participants in unauthorized private securities transactions. There is no evidence that the NASD's concerns about the risks of outside business activities and private securities transactions have abated or lessened over time. In 2001, the NASD quoted the North American Securities Administrators Association ("NASAA") as finding private securities transactions to be among the top 10 investment scams that year. *See* NTM 01-79, fn. 2. Again in 2011, NASAA's Enforcement Report (for 2010) identified "selling away" (*i.e.*, when registered representatives sold someone an investment product not sold or approved by their member firms) in the top 10 specific violations that NASAA members (*i.e.*, state securities regulators) took enforcement actions on.¹ As far as PIABA is aware, FINRA does not publish statistics on the number of registered representatives that have been punished by fine, suspension and/or a permanent bar for improperly engaging in private securities transactions.

It has been the experience of PIABA members that the investor losses from unreported (or inadequately supervised or prohibited) outside businesses and private securities transactions are still a major concern for PIABA members and our clients. Representatives who sell away can raise *millions* of dollars from dozens (and sometimes hundreds) of investors, which all too often are not fully recouped by the investors (if they are lucky enough to recoup anything). The result is irreparable damage to the victims' retirement savings. Over the years registered representatives continue to find new and creative ways to engage in these improper outside business activities and/or private securities transactions (examples include using outside business activities – both disclosed and undisclosed – to funnel customer funds, engaging in high risk trading that is not supervised by the member firm through a disclosed Registered Investment Advisory ("RIA"), or using other professional designations/fields such as being a Certified Public Accountants, insurance agent, or attorney to solicit investment for private ventures).

The rules currently provide a framework for regulating and supervising registered representatives in outside business activities and private securities transactions; however, FINRA has largely left member firms to devise supervisory procedures to comply with Rules 3270 and 3280.² This has led to inconsistencies

¹ As far as PIABA is aware, FINRA does not publish similar information such as annual statistics on the number of selling away cases pursued by FINRA Enforcement or the number of registered representatives that have been punished by fine, suspension and/or a permanent bar for improperly engaging in private securities transactions.

² The last time FINRA provided guidance on the supervision of outside business activities was in 1999. *See* NTM 99-45.

across the industry, which have allowed unscrupulous registered representatives to continue, and even increase, their misconduct. Comparatively, FINRA has provided more guidance on the supervision of member firms' dually registered Investment Advisory Representatives ("IAR"s) with respect to their private securities transactions conducted away from their member firms. For example, the NASD issued NTM 91-32, 94-44, and 96-33, which all provided more specific guidance on supervising registered representatives, who are also investment adviser representatives, in such securities transactions and how record on the member firm's books and records in compliance with FINRA rules.

PIABA believes that it would help investors if FINRA would provide similar more specific guidance to member firms concerning the supervision of outside business activities of its registered representatives, which is a more complex area of supervision. Issues with FINRA's existing guidance include the following: (1) a lack of recommended standards of conduct for the supervision of outside business activities; (2) the failure to sufficiently acknowledge and address the impact of shifts in the securities industry and the various models of doing business within the industry; (3) the failure to be pro-active in revising examination techniques/standards to account for changes in the way the securities industry does business (and the way scams are being perpetrated), too often revising or adopting new standards/techniques only after they are implemented by the SEC. These deficiencies result in delays to brokerage firms understanding the type and level of supervision expected of them with respect to outside business activities and private securities transactions, which then leaves investors susceptible to being victimized by their brokers.

PIABA proposes that FINRA issue an updated Regulatory Notice to provide guidance on the proper supervision of outside business activities and private securities transactions designed to detect infractions of the rules and to prevent registered representatives from participating in either without the advance knowledge and approval (with limitations, if necessary) of member firms. PIABA also suggests that any updated guidance issued by FINRA be thorough and specific like the guidance provided by SEC Staff Legal Bulletin No. 17: Remote Office Supervision ("SEC Bulletin").³

The SEC Bulletin clearly delineates various activities and categories of supervision that should be implemented with respect to remote offices and outside business activities, and PIABA believes that any updated guidance by FINRA on outside business activities and private securities transactions should be modeled after the SEC Bulletin. PIABA would like to see FINRA's updated guidance specifically address the following:

1. **Inspection requirements** – Identify criteria to determine how often inspections should occur and whether they should be announced in accordance with SEC decisions and prior guidance. *See* NTM 98-38 and NTM 99-45.
2. **"For Cause" Inspections** – PIABA is unaware of any specific guidance by FINRA on what factors a firm should consider in deciding whether to conduct a "for cause" inspection of an office due to the presence of red flags. FINRA should provide evaluative criteria or some examples from its examination experiences to assist in determining whether additional inspections would be warranted under certain circumstances.

³ See <https://www.sec.gov/interps/legal/mrslb17.htm>.

3. **Inspection of personal or outside business activity computers and phones** – While the SEC and FINRA have sanctioned firms for not inspecting personal computers, there is no specific guidance on the procedures for carrying out such audits. For instance, FINRA could specify that the registered representative is required to link their personal computer to the firm's network for a key word search.
4. **Inspection of personal and outside business activity email accounts** - While the SEC and FINRA have sanctioned firms for not supervising either personal email accounts or outside business activity email accounts, FINRA should provide specific guidance on the method and frequency of inspecting such accounts.
5. **Inspection of outside business activity bank accounts** – While the SEC has sanctioned firms for not supervising d/b/a and outside business activity bank accounts, FINRA should provide specific guidance on the method and frequency of inspecting such accounts.
6. **Inspection of social media** – There is no specific guidance on how frequently a firm should conduct public searches of a registered representative's social media to ensure compliance with the firm's policies on participation on a personal social media site. FINRA should provide such guidance
7. **Contacting investors** - While the SEC has sanctioned firms for not independently verifying information, there is no guidance as to when and how a firm should contact investors as part of an investigation into red flags. For instance, unusual liquidations of securities, large transfers of funds, and/or lack of adequate explanation by the registered representative as to why the transaction occurred should prompt a supervisor to call the client. PIABA is also aware of brokers downplaying the significance or reason for a supervisor's contact with a client, which can result in the client not taking additional steps necessary for the firm to be able to protect them. FINRA should provide specific guidance on when client contact is necessary and what should be communicated in such contact.

PIABA supports a Regulatory Notice as described above for the benefit of the investing public and members, which would provide updated and specific guidance on implementing, enforcing and supervising outside business activities and private securities transactions under existing FINRA rules. Technological developments have made supervision of employee activities easier and more efficient, but have also provided employees with additional ways in which they can communicate with investors about outside business activities or private securities transactions. FINRA needs to ensure that members firms know how to use all the tool at their disposal to supervise such communications.

PIABA thanks you for the opportunity to comment on this important topic.

Very truly yours,



Marnie C. Lambert
PIABA President