

# **FINRA's Attempt To Gut Investor Protections: Proposed Reforms To FINRA Supervision Rules**

Authored by:  
Andrew Stoltmann, Esq. and Adam J. Gana, Esq.<sup>1</sup>

## **Acknowledgements<sup>2</sup>**

## **Introduction**

FINRA's Stated Mission: "[S]afeguard the investing public against fraud and bad practices."<sup>3</sup>

The Financial Industry Regulatory Authority ("FINRA") is currently contemplating the evisceration of crucial protections that have been in place for decades to safeguard investors against investment schemes by brokerage firms' registered representatives, including "selling away" schemes.<sup>4</sup> If FINRA's proposed changes are approved, there will likely be more investment scams perpetrated by registered representatives.

## **Summary**

FINRA is currently contemplating proposed reforms to FINRA Rules 3270 and 3280 as outlined in FINRA Regulatory Notice 18-08 and detailed in the *Background on FINRA's Proposal* below. If these proposals are adopted, brokerage firms will no longer be held primarily responsible for identifying and stopping rogue brokers. The effect will be that brokerage firms will be less likely

---

<sup>1</sup> Andrew Stoltmann is a Chicago-based securities and investment fraud attorney. He is serving as the current President and a member of the Board of Directors for the Public Investors Arbitration Bar Association (PIABA), an international, not-for-profit, voluntary bar association of lawyers who represent claimants in securities and commodities arbitration and litigation. PIABA's mission is to promote the interests of the public investor in securities and commodities arbitration by seeking to: protect such investors from abuses in the arbitration process; make securities arbitration as just and fair as systematically possible; and, educate investors concerning their rights.

Adam J. Gana is a New York and Illinois based securities and investment fraud attorney. He is also serving on PIABA's Board of Directors.

<sup>2</sup> The Authors would like to thank Christopher L. Lufano and Adam J. Weinstein of Gana Weinstein LLP for their assistance in the research of this paper.

<sup>3</sup> See <https://www.finra.org/about/what-we-do>

<sup>4</sup> Selling away, a term often used in the brokerage industry among insiders and compliance personnel, involves a broker or financial advisor selling a private securities transaction to customers of a brokerage firm that are not sponsored by the brokerage firm and therefore have not been vetted by the firm. Brokerage firms and the financial industry generally prohibit such activities as it is misleading to investors who often believe if the registered representative is selling the product, the brokerage firm must be behind it.

to prevent selling away and other related schemes. These changes will create a regulatory and supervisory black hole that will insulate brokerage firms now serving as the first line of defense against selling away schemes at the direct expense of protecting investors.

### **Background on FINRA's Proposal**

FINRA is currently contemplating, under FINRA Regulatory Notice 18-08, eliminating almost all supervision requirements for registered representatives' outside business activities, including record keeping, with only two exceptions: 1) where a member approves an investment-related outside business activity and imposes conditions or limitations on the activity; and 2) where an approved investment-related outside business activity requires registration as a broker or dealer under the Securities Exchange act of 1934 ("Exchange Act").<sup>5</sup> FINRA proposes to exempt member firms from supervising:

- Investment related activities at third-party investment advisor firms ("IA");
- Investment related activities at member affiliates including IAs, banks, and insurance companies;
- Non-investment related work and outside business activities; and,
- Personal investments.

As a consequence of this proposed rule change, several categories of outside business activities currently under the supervision of brokerage firms would no longer be supervised, including but not limited to, non-approved private placements.

FINRA recognizes that current FINRA Rules 3270 and 3280 "serve important goals" in protecting investors from registered or associated persons who engage in "potentially problematic activities that are unknown to the member but could be perceived by the investing public as part of the member's business."<sup>6</sup> Nevertheless, proposed FINRA Rule 3290 will unreasonably narrow member's supervisory obligations and create exceptions to FINRA Rules 3270 and 3280 where none are needed or justified.

Additionally, proposed FINRA Rule 3290 will encourage the following adverse consequences, including: 1) supervisory deficiencies; 2) *de facto* violations of federal securities laws; 3) inconsistencies with other FINRA rules and regulatory guidance; and 4) perverse incentives for registered representatives and members. Accordingly, proposed FINRA Rule 3290 will erode investor protection where it is arguably needed most: "selling away" and private securities transactions.

---

<sup>5</sup> Regulatory Notice to Members 18-08, Outside Business Activities (Feb. 26, 2018), Attachment A.

<sup>6</sup> *Id.*, at 2.

## **Selling Away Activity**

For over 30 years, FINRA and its predecessor, the National Association of Securities Dealers (NASD), have emphasized that private securities transactions “present[] serious, regulatory concerns.”<sup>7</sup> The SEC has stated that:

[FINRA] Conduct Rule 3040 [prohibiting “selling away”] is designed not only to protect investors from unsupervised sales, but also to protect securities firms from liability and loss resulting from such sales. Such misconduct deprives investors of a firm’s oversight, due diligence, and supervision, protections investors have a right to expect.<sup>8</sup>

These private securities transactions (*i.e.* “selling away”) and other forms of outside business activities manifest themselves in a variety of schemes and fraudulent activity every year, including but not limited to, fraudulent private placements, Ponzi schemes, and investment frauds perpetrated through third-party IAs established by the registered representative. Despite the existing rules, each year FINRA registered representatives engage in schemes that defraud investors out of millions of dollars of irreplaceable retirement savings.<sup>9</sup> A common modus operandi in these schemes is for a registered representative to establish a solo or small IA firm and perpetrate the fraud through outside business activities in an effort to avoid member supervision.

### **FINRA’s Current Rules (3270 and 3280) Are Designed To Protect Investors**

Current FINRA Rules 3270 and 3280 impose broad but necessary supervisory responsibilities and obligations for registered representatives and member firms alike with respect to outside business activities and private securities transactions. The Rules are designed to achieve compliance with a member’s supervisory obligations under the Exchange Act and protect investors for fraudulent and other investment related schemes. Specifically, Exchange Act Section 15(b)(4)(E) provides that the SEC can sanction or revoke the registration of any member firm if it finds:

... that such broker or dealer... has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any person of any provision of the Securities Act of 1933, the Investment

---

<sup>7</sup> Notice To Members (“NTM”) 85-84.

<sup>8</sup> *In re Siegel*, 2008 SEC LEXIS 2459 at \*36 (Oct. 2, 2008), *aff’d Siegel v. SEC*, 592 F.3d 147, 156 (D.C. Cir. 2010) (citation omitted).

<sup>9</sup> <http://www.investmentnews.com/article/20111002/REG/310029969/selling-away-again-a-concern-for-regulators> (The North American Securities Administrators Association (“NASAA”) reported that in 2011 there were 54 enforcement actions involving selling away.)

Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, [the Securities Exchange Act of 1934], the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, *or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision.*<sup>10</sup>

The Exchange Act currently requires broker-dealers to supervise a representative's investment activities, no matter how or where the activity is executed, providing a prophylactic approach to supervision designed to prevent violations of the securities laws. The Exchange Act was written with the understanding that those who commit securities fraud might use various entity affiliations, whether registered or not, to perpetrate their frauds. As a result, a broker-dealer's responsibility to supervise reasonably and adequately the activity of its registered representatives is necessary to prevent violations of the securities laws.

FINRA Rules 3270 and 3280 impose broad supervisory responsibilities and obligations for registered representatives and member firms involved in outside business activities and private securities transactions, respectively. FINRA Rule 3270 concerns registered persons' outside business activities and imposes upon FINRA member-firms a duty to supervise said activities.<sup>11</sup> Specifically, FINRA Rule 3270 states:

No registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be compensated, or have the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member, in such form as specified by the member. Passive investments and activities subject to the requirements of Rule 3280 shall be exempted from this requirement.

FINRA Rule 3270 requires a registered person to disclose all outside business activities, whether investment-related or not, to the member in writing. Pursuant to the Rule and the Supplementary Materials thereto, the member is required to supervise the activity, and if necessary, prohibit the activity.<sup>12</sup>

---

<sup>10</sup> 15 U.S.C. § 78o(b)(4)(E) (emphasis added).

<sup>11</sup> See FINRA Rule 3270, OUTSIDE BUSINESS ACTIVITIES OF REGISTERED PERSONS; see also FINRA Rule 3270, Supplementary Material .01, OBLIGATIONS OF MEMBER RECEIVING NOTICE.

<sup>12</sup> *Id.*

Similarly, FINRA Rule 3280 concerns registered representatives' private securities transactions and imposes upon member-firms a duty to supervise said activities.<sup>13</sup> FINRA Rule 3280 states, in relevant part: "No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this Rule."<sup>14</sup> FINRA Rule 3280 provides for broad oversight and requires the member to supervise the private securities transaction regardless of whether it is for compensation or not.<sup>15</sup> Thereafter, the member may approve the transaction, in which case it shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member and record the transaction on its books and records, or disapprove of the transaction, in which case the person is prohibited from participating in the transaction.<sup>16</sup>

As detailed below, FINRA Rules 3270 and 3280 currently require full supervisory responsibility for an array of outside business activities and private security investment types.

FINRA Rule	Activity	Disclosure Required	Employee-Type	Member's Supervisory Responsibilities
<b>Rule 3270</b>	Selling Private Placements Away from Member (investment-related OBAs)	Yes	Registered Representative	Full supervisory responsibility
<b>Rule 3270</b>	Activities at Third-Party IA (investment-related OBAs)	Yes	Registered Representative	Full supervisory responsibility
<b>Rule 3270</b>	Non-Investment Related OBAs	Yes	Registered Representative	Full supervisory responsibility
<b>Rule 3270</b>	Activities at Affiliates	Yes	Registered Representative	Full supervisory responsibility
<b>Rule 3280</b>	Personal Investments (e.g. buying away)	Yes	Associated Person (broader)	Full supervisory responsibility

Given the wide scope of FINRA Rules 3270 and 3280 in their current form, FINRA's Department of Enforcement routinely relies upon these rules in regulatory and enforcement actions. Indeed, since the start of 2016, the Department of Enforcement has brought 194 and 68 enforcement

---

<sup>13</sup> See FINRA Rule 3280, PRIVATE SECURITIES TRANSACTIONS OF AN ASSOCIATED PERSON.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

matters pursuant to FINRA Rules 3270 and 3280, respectively.<sup>17</sup> Moreover, violations of FINRA Rules 3270 and 3280 form the basis of an undeterminable amount of securities fraud matters brought by investors in FINRA arbitration.

### **The Changes FINRA Proposed Will Harm Investors**

FINRA proposed changes to Rule 3290 will narrow and reduce members-firms' supervisory obligations and result in unacceptable adverse consequences, including: 1) dramatically weakening long-standing supervisory obligations; 2) creating glaring supervisory deficiencies; 3) encouraging *de facto* violations of federal securities laws; 4) generating inconsistencies with other FINRA rules and regulatory guidance; 5) producing perverse incentives for registered representatives and members; and 6) leaving investors with inadequate protection. FINRA's proposed changes to Rule 3290 will erode investor protection for outside business activities, "selling away," and other private securities transactions.

#### *The Changes Will Dramatically Reduce Long-Standing Investor Protections*

Despite the crucial role<sup>18</sup> FINRA Rules 3270 and 3280 play in the current FINRA regulatory and arbitration landscapes, FINRA seeks to replace these Rules with FINRA Rule 3290. This change poses a grave risk to investors and is inconsistent with FINRA's stated mission of protecting investors. FINRA's rationale for the changes is that "[t]he proposed rule would clarify the obligations in this area [outside business activities of registered persons] and reduce unnecessary burdens while strengthening protections relating to activities that may pose a greater risk to the investing public."<sup>19</sup> The adoption of FINRA Rule 3290 will undoubtedly ease the supervisory burdens of FINRA's member firms and their compliance departments. Unfortunately, it will also diminish crucial investor protections due to the obvious evisceration of important existing member supervisory responsibilities in connection with outside business activities. If implemented, the changes will inevitably lead to more selling away and similar schemes and it will leave defrauded investors with little recourse against this wrongdoing. As detailed below, proposed FINRA Rule 3290 would create an untenable regulatory framework and unreasonable supervisory structure that would exempt entire categories of outside business activities from member supervision and fail to protect brokerage firms' customers.

---

<sup>17</sup> Statistics derived from publicly available materials on FINRA's website (<http://www.finra.org/industry/finra-disciplinary-actions-online>).

<sup>18</sup> See FN 5, pg. 2.

<sup>19</sup> *Id.*

Activity	RR		Member Supervisory Responsibilities	Regulatory Loophole
	Disclosure Required	Risk Assessment		
<b>Selling Private Placements Away from Member (investment-related OBAs)</b>	Yes	Yes	<ul style="list-style-type: none"> <li>•If the member disapproves of the activity, then no supervisory obligation.</li> <li>•If the member approves the activity, then supervisory obligation + books and records</li> </ul>	No supervision of non-approved private placements
<b>Activities at Third-Party IA (investment-related OBAs)</b>	Yes	Yes	No supervisory obligation or books/records regardless of whether approved or not	No supervision of dually registered RR's at third party IA
<b>Non-Investment Releated OBAs</b>	Yes	No	No supervisory obligation	No supervision of non-investment related OBAs
<b>Activities at Affiliates</b>	No	No	No supervisory obligation, unless those activities would require reigstration as a broker or dealer	No supervision of activities of affiliates
<b>Personal Investments (e.g. buying away)</b>	No	No	No supervisory obligation, but potentially subject to FINRA Rule 3210	No supervision of personal investments
<b>RR v. Associated Member</b>	No	No	No supervisory obligation, but potentially subject to FINRA Rule 3210	No supervision of investment-related or non-investment related OBAs for associated members

### *Supervisory Deficiencies*

FINRA’s proposed Rule 3290 cannot be practically implemented by member firms and creates glaring supervisory deficiencies. As stated in the proposal “a member also must consider any ‘red flags’ indicating problematic activities” associated with its registered representatives’ activities.<sup>20</sup> However, under the Rule, the riskiest and most problematic activities will either be officially disapproved by the FINRA member or intentionally routed by an unscrupulous registered representative through a third-party IA, thereby eliminating any supervision by the member. Since proposed FINRA Rule 3290 eliminates record keeping requirements for third-party IAs, member firms will not have any legal obligation to supervise a registered representative’s conducted through the IA – a glaring regulatory deficiency.

The fragmented supervisory structure created by proposed FINRA Rule 3290 is best exemplified in the context of Ponzi schemes – one of the most nefarious forms of fraudulent outside business conduct to harm investors every year. For example, under the proposed rule a broker-dealer would be required to supervise a registered representative running a promissory note Ponzi scheme through an outside business activity that is not registered as an IA. However, under the proposed rule if the same registered representative established an IA, then the registered representative could evade his member firm’s supervision by running the promissory note Ponzi scheme entirely through the IA. FINRA member firms would likely claim that they conducted FINRA’s nebulous and meaningless “risk assessment,”<sup>21</sup> but was otherwise not required to supervise the activity.

<sup>20</sup> NTM 18-08, fn. 15.

<sup>21</sup> FINRA’s stated “risk assessment” test is meaningless as a supervisory device because it merely requires a brokerage firm to approve an activity based upon unverified assertions of its registered representative and without any due diligence or subsequent supervision of the activity. NTM 18-08, pg. 5 (the risk assessment “ordinarily would not require the member to perform an analysis of the underlying outside business activity.”); *Id.* pg. 6 (no supervision required if no conditions are placed on the activity).

Essentially, FINRA member firms would potentially be insulated from any liability related to the outside business activities of its registered representatives.

### *De Facto Exchange Act Violations*

Eliminating major components of a member-firm's supervisory requirements does not comply with the Exchange Act. NTM 18-08 states that "the proposed rule would not impose a general supervisory obligation over the IA activities..."<sup>22</sup> A rule limiting supervision of activity that could lead to a violation of the securities laws cannot be deemed reasonable under the Exchange Act. Consequently, a member firm could still be in violation of the Exchange Act even if it followed FINRA's guidance under the proposed rule.

For example, a member-firm that failed to supervise a registered representative who commits a violation of the Investment Advisers Act of 1940 through a third-party IA would likely be unable to demonstrate adequate supervision even if it followed FINRA's guidance under the proposed rule. The SEC has sanctioned brokerage firms in the past for failing to supervise third-party IA activity. In *In re Commonwealth Equity Services, LLP*, Bleidt, a registered representative, misappropriated over \$31 million from more than 100 victims.<sup>23</sup> Bleidt was dually registered with Commonwealth and was the owner of IA firm Allocation Plus Asset Management Company ("APAM"), "an independent investment adviser registered under the Advisers Act and not affiliated with or controlled by Commonwealth."<sup>24</sup>

The SEC stated that "[u]nder Section 15(b)(4)(E) of the Exchange Act, broker-dealers are responsible for reasonably supervising, with a view to preventing violations of the federal securities laws, persons subject to their supervision."<sup>25</sup> In *Commonwealth* the firm "failed to establish reasonable policies and procedures for responding to red flags related to Bleidt's outside business activities."<sup>26</sup> Specifically, the firm "did not review financial statements for one of Bleidt's businesses", a Boston radio station, and Bleidt misappropriated funds clients sent to APAM to fund his radio station and other ventures.<sup>27</sup> There are other similar examples of firms being sanctioned for failing to supervise third-party IA activities.<sup>28</sup>

---

<sup>22</sup> NTM 18-08, pg. 8.

<sup>23</sup> SEC Rel. No. 56362, 2007 WL 3071391 (Sept. 6, 2007).

<sup>24</sup> *Id.* at \*2.

<sup>25</sup> *Id.* at \*3.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *In re Signator Investors, Inc., et al*, SEC Rel. No. 75690 (Aug. 13, 2015) (finding that Signator failed to reasonably supervise both brokerage and advisory client activity of its representative leading to 125 clients being defrauded of \$13.5 million); *FINRA v. MidAmerica Financial Services, Inc.*, AWC No. 2012034475001 (FINRA, Jun. 2, 2014) (failing to supervise two broker's IA activities); *FINRA v. VFG Securities, Inc.*, 2014038997601 (Jan. 26, 2017) (same); *NFP Advisor Services, LLC*, AWC No. 2011025618702 (Jul. 16, 2015) (same).



FINRA's only stated justification for the proposed rule is that "these IA activities would continue to be subject to regulatory oversight by the SEC and states under a different regulatory scheme."<sup>29</sup> However, FINRA's reasoning does not address the Exchange Act's Section 15(b)(4)(E) supervisory requirements that broker-dealers supervise their representatives with a view toward preventing violations of the securities laws. Regardless of FINRA's proposed reliance on "a different regulatory scheme" of the states, no supervisory exemption exists in the Exchange Act for supervision and the proposed rule provides FINRA members no relief from their obligations under the Exchange Act. Ultimately, FINRA's proposed rule leaves member-firms defenseless to a charge of failure to supervise under the Exchange Act and unable to claim the available statutory defenses.<sup>30</sup>

### *Inconsistencies with Other FINRA Rules and Guidance*

FINRA's proposed rule would be in direct conflict with multiple FINRA rules and NTMs on far-reaching issues such as supervision, suitability, record keeping, and branch audits that have been established over the last 30 years. If the proposed rule were implemented, FINRA would have to amend numerous FINRA rules and spend years clarifying whether or not dozens of previously issued NTMs were intended to be modified by the proposed rule and/or how firms would be expected to still comply with prior guidance. If FINRA Rule 3290 is adopted, then FINRA members, and investors will be forced to proceed under a cloudy set of rules and regulatory guidance concerning outside business activities.

Unfortunately, FINRA Rule 3290 potentially implicates FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) and its adoption would create mass confusion for brokerage firms and registered representatives. For example, a recommendation to a registered representative's client to sell all of their assets at a FINRA member firm to invest entirely in private placements at the registered representative's IA would be a recommendation or investment strategy that the registered representative's member would have to supervise under NTM 12-25. Yet, FINRA's rule proposal does not provide guidance on how a brokerage firm can effectively supervise a registered representative's liquidation and transfer of assets to an IA under the registered representative's control and how to comply with NTM 12-25's suitability requirements in relation to the recommended transactions.<sup>31</sup> Thus, despite the proposed rule incentivizing registered

---

<sup>29</sup> NTM 18-08, pg. 8.

<sup>30</sup> "no person shall be deemed to have failed reasonably to supervise any other person, if (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with." 15 U.S.C.A. § 78o(b)(4)(E).

<sup>31</sup> See also NTM 12-25, pg. 8 (Similarly NTM 12-25 states that "[s]uitability obligations apply...to a broker's recommendation...to liquidate securities to purchase an investment-related product that is not a security" but it is unclear whether or not FINRA members would have to supervise these transactions occurring in part at other financial institutions under the proposed rule).

representatives to move assets from brokerage accounts to their IA in order to make recommendations in products and services that their member-firm would not approve, member-firms will be without guidance and investors will be left without protection.

Other aspects of previous suitability guidance are also impacted. FINRA has stated that the suitability rule “requires a broker to seek to obtain and analyze a customer’s other investments. The rule thus explicitly permits a suitability analysis to be performed within the context of a customer’s other investments.”<sup>32</sup> Nonetheless, FINRA’s proposed rule is silent as to whether and/or how FINRA member firms are to obtain information about and analyze a registered representative’s client’s investments at the FINRA member firm along with the client’s investments made through an IA for suitability.

Finally, the proposed rule also clearly contradicts prior SEC guidance and fails to clarify whether or not FINRA is proposing to limit the scope of branch audits and its joint guidance with the SEC under NTM 11-54. FINRA’s proposed rule states that “[i]f an activity is not investment related, the FINRA member has no [supervisory] obligation under the rule.”<sup>33</sup> Yet, the SEC has stated that “a firm should be alert to and investigate ‘red flags’ indicating possible undisclosed outside business activities and *asses all outside business activities by a representative, whether or not related to the securities business.*”<sup>34</sup>

The NASD stated long ago that off-site employees who engage in other non-securities businesses “have a greater opportunity than on-site personnel to engage in undetected selling away. Consequently, firms that employ such persons are responsible for monitoring their activities in a manner reasonably intended to detect violations.”<sup>35</sup> FINRA has also recommended that branch office inspections “identify the nature and extent of outside business activities of registered branch office personnel. Outside business activities conducted by registered persons may carry added risk because these activities may be perceived by customers as part of the FINRA member’s business.”<sup>36</sup> As a result, if FINRA Rule 3290 is adopted, then FINRA must modify and/or significantly revamp various other FINRA rules concerning, *inter alia*, suitability, record keeping, and branch audits.

Proposed Rule 3290 creates various carve outs and exceptions that invite unscrupulous registered representatives or FINRA members to manipulate the rule to either evade or disavow supervision. For example, registered representatives seeking to violate securities laws will be incentivized to establish IAs practices in order to shield their unlawful activities from the supervision of their

---

<sup>32</sup> NTM 12-25, pg. 13.

<sup>33</sup> NTM 18-08, pg. 5.

<sup>34</sup> Staff Legal Bulletin No. 17: Remote Office Supervision, SEC Rel. No. SLB-3A(CF), 2004 WL 5698359 (Mar. 19, 2004) (emphasis added) (“The Commission has recognized that there is a risk that representatives will use outside business activities to carry out or conceal securities law violation.”).

<sup>35</sup> NTM 86-65.

<sup>36</sup> NTM 11-54, pg. 2.

FINRA member firms. Similarly, registered representatives seeking to engage in investment-related outside business activities (where supervision is required under the proposed rule) will be incentivized to provide minimal and/or incomplete information to the firm to create the appearance the outside business is non-investment related.

Moreover, under the proposed rule FINRA member firms will have a perverse incentive to disapprove proposed outside business activities wherever possible in order to disclaim supervisory responsibility. Under the proposed rule, approved outside business activities require the firm to supervise the activity and record the activity on the firm's books and records, whereas, as disapproved activities require no oversight. Given that the impetus for proposed FINRA Rule 3290 was to reduce supervisory burdens placed upon member-firms, FINRA clearly believes that it is likely that more outside business activities will be disapproved than approved under the proposed rule. Unfortunately, the savings to member-firms having to do less supervision of registered representatives will come at the expense of FINRA fulfilling its mission of safeguarding the investing public against fraud and bad practices. In the end, it will be investors that pay the price for this misguided proposed rule in the form of additional risk and lack of supervision for outside business activities.

### **Conclusion**

FINRA's claimed mission is to "safeguard the investing public against fraud and bad practices."<sup>37</sup> Fraudulent outside business activities pose a serious risk to investors as evidenced by the numerous examples of fraudulent private placements, Ponzi schemes, and investment frauds perpetrated through third-party IAs. FINRA rules need to be expanded to provide greater supervisory oversight and investor protection for outside business activities – not less as is currently being contemplated by FINRA. If FINRA implements the changes it is proposing, it will significantly reduce brokerage firms' obligations with respect to supervising their registered represents and pose a grave risk to investors.

---

<sup>37</sup> See <https://www.finra.org/about/what-we-do>