

Comments on Regulatory Notice 18-08 Proposed Rule 3290 (Outside Business Activities)

BUSINESS LAW SECTION COMMITTEE ON SECURITIES REGULATION

BLS #3

May 4, 2018

Via Electronic submission to: pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, D. C. 20006-1507

Re: Regulatory Notice 18-08
Proposed Rule 3290 (Outside Business Activities)

Dear Ms. Mitchell:

The Committee on Securities Regulation (the “Committee”) of the Business Law Section of the New York State Bar Association appreciates the invitation in Regulatory Notice 18-08 to comment on proposed Rule 3290 (Outside Business Activities).

The Committee is composed of members of the New York Bar, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and in corporation law departments. A draft of this letter was reviewed by certain members of the Committee, and the views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, are those of the Committee and do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association, or its Business Law Section.

Summary

Proposed Rule 3290 (the “Rule”) would replace current Rule 3270 (Outside Business Activities) and current Rule 3280 (Private Securities Transactions). It would reduce the burdens on registered persons to give notice to their member firm of proposed business activities by excluding some categories of activities, and would reduce the burden on member firms to supervise registered persons engaged in outside business activities for certain entities that are affiliates of the member firm or outside business activities not requiring registration as a broker, unless the member believes supervision is otherwise necessary.

This proposal is one result of FINRA's review of its existing rules to clarify and reduce their burdens on member firms and associated persons. We commend FINRA for the proposed Rule which, we believe, provides more clarity and strikes the proper balance between outside business activities that require supervision and those that do not, and gives members more flexibility in determining what supervision is appropriate in the context of their businesses.

Our comments on the proposal follow.

Comments

Registered Person Changing Association or Forming New Member Firm. We believe it would be helpful to registered persons if the Rule clearly stated that it does not require the giving of notice and obtaining of approval to negotiate and enter into employment or association with another member firm or registered investment adviser, or to form and register a new broker-dealer or investment adviser.

In a December 6, 2001 Interpretive Letter the NASD's Assistant General Counsel advised that then Rule 3030 (Outside Business Activities) would not apply to a registered person working for a member firm who would like to enter into an agreement to become employed with another member firm or to form a new company that would file an application for membership with the NASD. This letter was given in the context of the tragedies of September 11, 2001. We urge that this be included in the Supplementary Material to Rule 3290.

Due Diligence; Use of Member's Name. In Request for Comment 5(c), FINRA asks whether the risk assessment required by paragraph (b)(1)(a) of the Rule should "include a requirement for the member to perform due diligence of the underlying outside activity." We believe that due diligence should not be required as an element of the risk assessment, because the cost of due diligence could act as a deterrent on permitting registered persons to engage in outside business activities. However, we are mindful that there is a risk of misuse of the member's name and reputation if it is associated with a business over which it has no control. We believe it would be helpful to advise members that in assessing the risk that the registered person's proposed activity will be viewed by customers or the public as part of the member's business, the member should consider whether the registered person's association with the member is likely to be considered as significant or as an indicator of the quality or reputability of the outside business. Ways to manage such a risk might include performing due diligence to ascertain whether participation by the registered person in the outside business will be misleading or prohibiting the registered person or the outside business from using the member's name other than to state that the registered person is registered with the member, and in those circumstances requiring them to state that the member has no participation in the business.

Supervisory Responsibility for Employees of Two or More Member Firms. In the case of a person whose outside business activity is with another member firm, the proposed rule would allow the two firms (or more than two firms, if that is the case) to agree among themselves as to the allocation of supervisory duties. We note the requirements of Exchange Act Section 15(b)(4)(E), which authorizes the SEC to sanction a firm for failure to supervise the activities of its personnel. We request that FINRA add Supplementary Material stating that such an arrangement would be presumed to satisfy the conditions of Section 15(b)(4)(E)(i) and (ii) with respect to the supervisory obligations of the member allocating supervisory responsibility to the other member. We appreciate that this may raise questions about FINRA's authority to create that presumption, but it is a question raised by proposed Rule 3290(b)(4) itself.

Definition of "Business Activity". "Business activity" is defined in Supplementary Material .02(b) to include "receiving compensation, or having a reasonable expectation of compensation," as a result of an activity. Notice to Members 96-33 provided that even if no compensation was paid, but there was an expectancy of compensation, whether then or at some future time, the rule would apply.

We request that FINRA make clear that if there is no reasonable expectation of compensation at the time the outside business activity is commenced, there is no requirement for notice and a determination by the member, but that, if the registered person thereafter has a reasonable expectation of compensation, the registered person must promptly provide notice to the member, initiating the member's obligations in proposed Rule 3290(b).

We would be happy to discuss our comments further with the Staff.

Respectfully submitted,
COMMITTEE ON SECURITIES REGULATION

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