COMMONWEALTH *financial network*

April 27, 2018

By Electronic Mail (pubcom@finra.org)

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

RE: FINRA Regulatory Notice 18-08: Outside Business Activities and Private Securities Transactions

Dear Ms. Mitchell:

Commonwealth Financial Network® ("Commonwealth") welcomes and appreciates the opportunity to comment on FINRA's Request for Comment on Proposed New Rule 3290 pursuant to Regulatory Notice 18-08 (the "Notice"). There are several aspects of the Notice that cause us concern and should be modified. These concerns are discussed in further detail below.

Commonwealth is an independent broker/dealer and an SEC-registered investment adviser with home office locations in Waltham, Massachusetts, and San Diego, California. Commonwealth has more than 1,700 producing registered representatives who are independent contractors conducting business throughout all 50 states.

Non-Investment Related Outside Business Activities

We generally support the requirement that registered persons provide prior written notice to, and receive prior written approval from, their member firm before participating in any investment related activity. However, registered persons should not be required to disclose non-investment related business activities to their members beyond that which is already required to be disclosed by such persons on Form U4.

Under proposed FINRA Rule 3290, the definition of an outside business is any activity where a registered person is:

> *"(i) acting as an employee, independent contractor, sole proprietor, officer, director or partner of another person, or (ii) receiving compensation, or having the reasonable expectation of compensation, from any other person as a result of the activity, outside the scope of the relationship with the person's member firm."*

There are a wide range of non-investment related outside business activities that pose little to no risk to the public or to a member's customers. Requiring disclosure of non-investment related activities to member firms, when such disclosures must already be made on Form U4, creates unnecessary redundancy and increased compliance costs for both registered persons and member firms, provides no meaningful investor protection, and will serve only to increase the potential liability of firms for activities that have nothing to do with the member firm. We offer the following as illustrations of these points.

A. Non-Profit Organization Activities.

The instructions for Form U-4 for the disclosure of outside business activities excludes any activity "that is exclusively charitable, civic, religious or fraternal, and is recognized as tax exempt." FINRA should modify proposed Rule 3290 to exclude non-investment related activities in which a registered person acts as an independent contractor, sole proprietor, officer, director or partner of another person which is exclusively charitable, civic, religious or fraternal, or is otherwise recognized as tax exempt, and for which the registered person receives no compensation, from the definition of outside business activities.

Registered persons routinely seek to give back to their local communities, and they are often sought out by non-profit and civic organizations to serve on boards or as officers of charitable organizations. Persons who engage in these activities typically do so for no compensation, and the amount of time that registered persons devote to these activities during business hours is minimal at best. As such, these activities do not materially impact a registered person's ability to fulfill his or her obligations to their clients or the members' customers, and they should be excluded from the disclosure requirements.

B. Legal and Regulatory Liability Resulting from Non-Investment Related Outside Activities Disclosures

As part of civil litigation, we have experienced cases relating to a registered person's non-investment related outside business activities (e.g., tax preparation services, legal services, etc.) that have named our firm in legal claims relating to the registered persons' involvement in the activity, solely because Rule 3270 requires members to receive written notice and approve the activity. Litigation attorneys are very much aware that registered persons and their employing members are subject to FINRA' s rules, and they have successfully leveraged this fact with FINRA arbitration panels by arguing that members have an affirmative responsibility to oversee their registered person's participation in the non-investment related outside business activities member firms have approved. While such claims against the member lack legal merit and are not supported by Rule 3270, FINRA arbitration panels have allowed these claims to be litigated solely because they happen to involve a customer of the member firm. In turn, member firms have had to incur legal costs to defend these meritless claims.

Under proposed Rule 3290 FINRA has stated that member firms would not have to conduct risk assessments of any non-investment related outside business activities. Nevertheless, if FINRA rules continue to require registered persons to disclose non-investment related outside business activities to their member firms, those firms must continue to devote precious resources to enforcing the disclosure requirement, despite the fact that no approval or supervision is required. Moreover, plaintiff's attorneys will continue their attempts to hold member firms accountable for a registered person's non-investment related outside business activities solely because the member received notice of the activity. Those member firms that wish to implement policies that require registered persons to disclose non-investment related activities may still do so, but FINRA should not mandate such disclosure.

C. Harmonization with SEC Requirements on Outside Business Activity Disclosures

FINRA must continue to harmonize its rules with the SEC wherever its rules are redundant to, or materially different than, SEC rules. IF FINRA insists that registered persons must continue to disclose non-investment related outside business activities to their member firms beyond that which is already

required on Form U4, FINRA should consider limiting such disclosure to those activities that are required to be disclosed by supervised persons of investment advisers. Under the Form ADV Part 2B Brochure Supplement disclosure requirements, in addition to disclosing investment related business activities supervised persons must disclose other non-investment related business activities that involve a substantial amount of supervised persons' time or income. The SEC allows advisers to make a presumption that if the other business activity involves less than 10% of the person's time and income, the activity would not be considered "substantial."

Nearly all of Commonwealth's registered representatives are also investment adviser representatives of either Commonwealth's registered investment adviser or a separately registered investment adviser. As a result, these registered persons are already required to disclose material outside business activities on their Part 2B Brochure Supplements. That disclosure is in addition to existing Form U4 disclosures and FINRA Rule 3270. It is not reasonable that FINRA should require registered persons of a broker-dealer to disclose outside business activities that supervised persons of an investment adviser are not required to disclose, or to be subject to three separate outside business activity disclosure requirements.

If FINRA will not remove the requirement that registered persons separately disclose all outside business activities to member firms beyond that which must already be disclosed on Form U4, it should at least take this opportunity to harmonize proposed Rule 3290 with the Other Business Activities disclosure requirements applicable to an investment adviser's supervised persons. Doing so will provide consistent disclosure of outside business activities to both broker-dealers and investment advisers and will reduce the unnecessary costs, duplications and burdens of dually registered persons needing to comply with the three separate reporting obligations currently applicable to Commonwealth's registered persons.

Members' Obligations relating to Registered Person's Investment Related Outside Business Activities

We support FINRA's proposal that members conduct risk assessments of disclosed *investment-related* outside business activities of registered persons, and to supervise any conditions or restrictions imposed upon the registered person by the member while engaging in the investment-related activities. However, there are some aspects of proposed Rule 3290 relating to member's obligations that cause us concern as they will likely expose both the public and member firms to substantial financial risks.

A. Fixed Insurance and Personal Real Estate

For the purpose of Rule 3290, FINRA has included within the definition of investment related outside business activities any activity relating to insurance and real estate. There is an array of insurance and real estate outside business activities that pose no significant investment risk to the public or to the members' customers (e.g., fixed insurance sales, registered persons leasing or renting their personal property). FINRA should modify its definition of investment-related outside business activities relating to insurance and real estate activities to omit from disclosure certain non-investment related insurance and real estate activities. Specifically, FINRA should consider eliminating from the definition of investment related outside business activities the sale of life, fixed annuity, health, property and casualty, and long-term care insurance products, as well as activities relating to leasing or renting real estate property personally owned by a registered person.

B. Risk Assessments

Under proposed FINRA Rule 3290, members would be required to conduct a risk assessment of investment-related outside business activities to consider whether the registered person's involvement in the activity would:

> (*1) interfere with or otherwise compromise the registered person's responsibilities to the member and/or the member's customers, or*
>
> *(2) be viewed by the member's customers or the public as part of the member's business based upon, among other factors, the nature of the proposed activity and the manner in which it will be offered.*

In describing the requirements for the member's risk assessment, FINRA has stated that members need only consider the registered person's role in the proposed business activity, but would not have to "*ordinarily*" consider the risks of the underlining business activity. As described by FINRA, the stated purpose for requiring members to undertake the risk assessments is *"assessing possible conflicts that could negatively impact the member's customers or the investing public.*" Further, as discussed in Footnote 15 of the Notice, FINRA expects members to consider all "red flags" of problematic outside business activities. It is fundamentally inconsistent for FINRA to expect firms to consider all "red flags" and conflicts that could negatively impact customers or the public, without also considering the risks of the underlying activity. Doing so would almost certainly raise questions about the adequacy of the risk assessment performed by the firm and lead to litigation by plaintiff's attorneys, and perhaps regulatory action by FINRA as well, based upon 20/20 hindsight. FINRA must clearly define the obligations and expectations of member firms as relates to conducting the risk assessment, *without* the ambiguity that exists in the proposed rule.

C. Supervision

FINRA expects member firms to supervise the conditions and limitations set by them in approving the investment-related outside business activities of their registered persons. For those investment related activities in which members impose no conditions or restrictions on the registered persons' engagement in the activity, members may be likely to infer, based on the language of proposed Rule 3290, that they have no ongoing supervisory obligations relating to the activities. However, unless specifically stated otherwise, we expect that FINRA will continue to hold member firms accountable for a variety of supervisory obligations under other FINRA Rules, such as Rules 2210 (Communications with the Public), 5270 (Front Running of Block Transactions), and 2010 (Just and Equitable Principles of Trade).

For example, most member firms require their registered persons to use their "hosted" email systems, among other things. From an administrative, operational and practical perspective, it would be virtually impossible for firms to exclude or ignore investment-related outside business activities from review even though they *may* not be "required" to supervise the activity under proposed Rule 3290. We believe FINRA's assertion that the proposed rule "should simplify the supervisory efforts and lower the direct compliance costs" of member firms will actually prove to have the opposite effect.

D. Unaffiliated Third Party Registered Investment Adviser Activities

One of the purported benefits of proposed Rule 3290 is that members would not have to supervise registered persons' investment related outside business activities with unaffiliated third-party investment advisers. In its many public statements about limited examination resources, the SEC has made clear that it is ill-equipped to routinely examine the many investment advisers it regulates. Similarly, due to limitations on many State regulatory resources and budgets, States also substantially lack sufficient resources to examine State-registered investment advisers with any reasonable regularity, if at all. Eliminating the current requirement for member firms to supervise their registered persons' investment related outside business activities with unaffiliated third party registered investment advisers, without ensuring that sufficient regulatory resources exist to routinely examine such activity in the absence of member firm oversight, raises significant investor protection concerns.

FINRA Rule 3280 and Notice to Members 94-44 and 96-33 require member firms to supervise and record on the members' books and records transactions resulting from the outside IA activities of their associated persons. FINRA has neither routinely nor consistently enforced those requirements on member firms that permit such activity. While some firms have implemented reasonable systems to supervise the activity and others have chosen to prohibit the activity outright, many firms have served as a haven for registered persons to engage in outside IA activity knowing that there will be little or virtually no oversight by their member firm in relation to the activity. Proposed Rule 3290 would reward the latter firms at the expense of investor protection and those firms who have played by the rules.

Additionally, removing the supervisory obligations for these activities will undermine a member firm's authority and ability to fulfill their supervisory obligations under other FINRA Rules (e.g., front running of block transactions, personal securities trading, etc.). Contrary to FINRA's assertion that eliminating the supervision obligation for these activities will eliminate compliance costs for members, given the integration of member firms supervisory systems, particularly as they relate to the supervision of written communications and transaction reviews, it would in fact be *more* burdensome for member firms to supervise their registered persons, not less. Moreover, the costs to the public, members' customers, and member firms themselves in the event of fraudulent or abusive trading activity, market manipulation, and similar circumstances will substantially outweigh any purported cost savings for member firms.

Therefore, we urge FINRA to modify proposed Rule 3290 to mandate that member firms that choose to permit their registered persons to conduct outside IA activity must supervise their registered persons' investment related outside business activities with unaffiliated third-party investment advisers. Moreover, FINRA should routinely and uniformly examine those firms for ongoing compliance with the supervision and books and records rules attendant to such activity.

Personal Securities Transactions

FINRA is proposing to eliminate the disclosure of registered persons' personal investments under proposed FINRA Rule 3290. On the surface this proposal would appear to save costs for member firms and be a welcome change. Upon further consideration, however, the elimination of the personal securities transaction disclosure requirement by registered persons raises potentially significant investor protection concerns. By eliminating such reporting by registered persons to their member firms, those firms will lose a valuable tool that is currently available that may help them identify potential "red

flags" that may suggest inappropriate conduct. Reports about the type, nature, frequency, amount, scope and funding sources of a registered person's personal investments may, in some cases, be material information for member firms. While certainly not a common occurrence, unusual or otherwise unexplained personal investments by registered persons, particularly when they involve private placements, novel or high-risk investments, may provide reasonable cause for the member firm to initiate an internal review. Whereas such transactions are not reportable to member firms under Rules 3210 or 5210, absent a separate reporting obligation these transactions would not otherwise be known to the member and may ultimately lead to investor harm.

FINRA has initiated many disciplinary actions against registered persons for their participation in private securities transactions in which they solicited a member's customers or the public to invest in a private security without the knowledge or approval of the member firm. In many cases, these registered persons failed, in whole or in part, to disclose to their member firms the full scope of their involvement in the transactions because the activities started out as personal investments or outside business activities that morphed into unapproved private securities transactions. Eliminating the disclosure of registered persons' personal investments to their member firms may only serve to exacerbate these types of cases, to the detriment of investors.

An additional consideration is that Codes of Ethics Rule 204A-1 under the Investment Advisers Act requires an investment adviser's access persons to submit quarterly reports of all personal securities transactions by the access person. Rule 204A-1 also requires access persons to obtain their firm's approval *before* investing in private placements. The rule requires investment advisers to review their access person's personal securities transactions to identify, among other things, potential transactions that could disadvantage clients while benefiting the access person. Whereas similar investor protection issues exist with respect to broker-dealers, it seems appropriate that the obligation to disclose personal investments by registered persons of broker dealers should be harmonized with the personal securities reporting requirements applicable to investment advisers.

For the reasons discussed in this letter we urge FINRA to reconsider its approach to proposed Rule 3290.

If you have any questions or would like to further discuss these issues, please do not hesitate to contact me.

Respectfully,
COMMONWEALTH FINANCIAL NETWORK

Paul J. Tolley
Senior Vice President
Chief Compliance Officer