

May 7, 2025

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Office of the Corporate Secretary
FINRA 1700 K Street, NW
Washington, DC 20006

Re: Regulatory Notice 25-05 - Outside Activities

Ms. Mitchell:

I am writing to comment on FINRA's Regulatory Notice 25-05, specifically regarding the proposed treatment of outside investment adviser (IA) activities under the consolidated rule.

SUMMARY OF POSITION

The proposal would maintain FINRA's current approach of requiring broker-dealers to supervise outside IA activities of their registered representatives. This requirement is fundamentally flawed from a jurisdictional perspective and should be eliminated.

LACK OF CLEAR REGULATORY STANDARDS

FINRA expresses "duty to supervise" amorously: there are no specifics as to what, how, when, or to what extent a broker-dealer must supervise IA activities. In absence of clear and narrow requirements, the broadest oversight program must be implemented by member firms, but such an imposition is beyond FINRA's jurisdiction to compel. The profound expense and consumption of resources of a broker-dealer supervision program of investment advisers was never granted to FINRA by Congress to so tax member firms.

STATUTORY AUTHORITY LIMITATIONS

FINRA has been granted authority by Congress through the Securities Exchange Act of 1934 to regulate broker-dealers. Investment advisers, by contrast, are regulated by the Securities and Exchange Commission and state securities regulators under the Investment Advisers Act of 1940, a completely separate statutory framework. FINRA has no statutory authority whatsoever to regulate investment advisers or investment advisory activities.

By requiring FINRA member firms to supervise outside IA activities, FINRA is asserting indirect regulatory control over investment advisory activities. This assumption of authority is

clear regulatory overreach that is *ultra vires* - beyond FINRA's legally granted powers. FINRA cannot indirectly regulate through the back door what it lacks the authority to regulate directly.

JUDICIAL PRECEDENT AGAINST REGULATORY OVERREACH

Recent judicial precedent reinforces this position. In *SIFMA v. Ashcroft*, No. 23-cv-04154-SRB, (W.D. Mo., 2024), a federal court ruled that even state securities regulators (which possess greater sovereign authority than FINRA) are significantly constrained in their ability to regulate investment advisers due to federal preemption under the National Securities Markets Improvement Act of 1996 (NSMIA). The court specifically cited Section 80b-3a(b)(1)(A) of the Investment Advisers Act, which limits state authority over federally registered investment advisers. In this case, the Securities Industry and Financial Markets Association (SIFMA) successfully challenged Missouri's attempt to regulate investment advisers regarding investment decisions, with the court finding such regulation exceeded the state's authority.

If sovereign states are limited in their authority over investment advisers by federal law, FINRA—as a non-governmental self-regulatory organization with powers derived solely from the Exchange Act of 1934—certainly cannot possess greater authority. FINRA's jurisdiction is even more constrained than that of state regulators concerning investment advisers, as FINRA is nowhere contemplated or mentioned in NSMIA.

VIOLATION OF FEDERALISM PRINCIPLES

Investment advisers can be subject to state or federal regulation, depending on the nature of the business and the assets under management. FINRA's duty to supervise extends to both classes of advisers. Perhaps most shocking is how FINRA's requirements effectively create a system whereby a private, non-governmental organization with authority stemming solely from the Exchange Act is supervising state-registered investment advisers—an unbelievable and horrific overreach that violates fundamental principles of federalism. NSMIA carefully delineated boundaries between federal and state regulation of investment advisers, respecting state sovereignty while creating a coherent national framework. FINRA's supervision requirements obliterate these boundaries by subjecting state-registered advisers to de facto oversight by broker-dealers compelled by a federal SRO.

This creates an absurd scenario where FINRA, which has no authority over investment advisers under federal law, and has no authority under any state law, is nevertheless exercising indirect control over advisory activities that Congress explicitly reserved to state regulation. The implications for federalism are profound—FINRA has effectively positioned itself above both state regulators and the carefully balanced federal-state regulatory structure established by Congress, inserting itself into regulatory relationships where it has no legitimate role.

SPECIFIC PROBLEMS WITH JURISDICTIONAL OVERREACH

The jurisdictional overreach is particularly problematic because:

1. It creates an unauthorized and duplicative layer of regulation for investment advisory activities that are already subject to comprehensive regulation by the SEC and state securities regulators.
2. It imposes significant costs and compliance burdens on broker-dealers without any legitimate authority—functionally equivalent to a private organization imposing an unauthorized tax. Financial professionals are routinely sanctioned by FINRA for misrepresenting the features or capacities of their products and services, yet FINRA appears to be misrepresenting its own regulatory authority over investment advisers.
3. It creates practical challenges related to privacy laws and information sharing between unaffiliated entities.
4. It blurs the distinct regulatory frameworks Congress established for broker-dealers and investment advisers, giving the misleading appearance that FINRA possesses supervisory authority over investment advisers that it does not legally have.
5. It undermines democratic governance by acting in contravention of congressionally delegated powers, effectively depriving voters of their right to construct a government of their choosing through their elected representatives.
6. For dual registrants, FINRA's overreach creates an untenable regulatory morass. Individuals legitimately operating in both capacities—as broker-dealer representatives and investment adviser representatives—face contradictory requirements and overlapping, sometimes conflicting supervision. The same advisory activity could simultaneously be subject to SEC/state regulation (properly) and broker-dealer supervision (improperly), creating regulatory schizophrenia where professionals must satisfy different masters for identical activities. This regulatory confusion doesn't enhance

investor protection; rather, it forces dual registrants to navigate a compliance labyrinth that Congress never intended to create. The result is not enhanced oversight but fragmented, contradictory regulation that undermines the coherence of either regulatory framework.

ULTRA VIRES NATURE OF REQUIREMENT

Any requirement by FINRA that exceeds its congressionally authorized jurisdiction is facially void and unenforceable. Supervision is regulation. Member firms cannot be obligated to follow rules that FINRA has no authority to impose. FINRA itself holds financial professionals to the highest standards regarding representations of authority and capacity; it should apply those same standards to its own regulatory actions and refrain from asserting authorities it does not possess.

FINRA'S HISTORY OF ATTEMPTED EXPANSION

FINRA's continued efforts to maintain regulatory hooks in investment advisers are foreboding reminders of FINRA broader ambitions, particularly FINRA's prior extensive lobbying history to gain control over investment advisers. From 2008-2012, FINRA spent approximately \$4 million lobbying to expand its authority into the IA space, it hired former House Financial Services Committee Chairman Michael Oxley to promote its agenda, and it publicly supported H.R. 4624 (the "Bachus Bill") which would have granted FINRA authority over investment advisers.

Investment advisers have consistently and vehemently opposed FINRA's regulatory expansion into the IA space, preferring to remain under SEC oversight. Despite this clear and unified opposition from the investment adviser community and the failure of H.R. 4624 to advance, there is worry that FINRA has never abandoned its IA ambitions. Industry observers have noted FINRA is merely "playing the long game" and "laying the groundwork for a future lobbying effort," viewing advisers as a lucrative "regulatory and revenue opportunity."

In this context, FINRA's current rule requiring broker-dealer supervision of investment adviser activities appears to be a strategic positioning tactic—maintaining tenuous connections to adviser regulation that can later be leveraged to justify expanded authority. This represents not just a jurisdictional overreach but a deliberate encroachment strategy that threatens the distinct regulatory framework Congress established for investment advisers. FINRA must be completely

separated from investment adviser regulation unless explicitly authorized by Congress through legislation—not through regulatory back doors and supervisory mandates.

ARBITRATION SYSTEM ABUSES

FINRA's jurisdictional overreach takes on even more alarming dimensions when considering how its supervision requirements create new liability exposures for broker-dealers through FINRA arbitration. The 2018 Spire Securities case illustrates this dangerous precedent: FINRA arbitrators awarded \$3 million to investors harmed by an unrelated and unaffiliated investment adviser's Ponzi scheme, holding the broker-dealer liable merely because the fraudster was also registered with the firm, despite the fraud occurring entirely through the unaffiliated RIA.

This case demonstrates how FINRA's supervision mandate creates a constitutionally impermissible, backdoor private right of action against broker-dealers for conduct occurring entirely within an investment advisory relationship—a relationship governed exclusively by the Investment Advisers Act, which FINRA has no authority to enforce. The dissenting arbitrator recognized this jurisdictional boundary, yet FINRA's self-created "duty to supervise" effectively nullified those limits.

FINRA's jurisdictional overreach represents a particularly troubling form of regulatory bootstrapping: first, it imposes an ultra vires requirement on broker-dealers to supervise outside investment advisory activities; then, when fraud occurs in those advisory relationships, FINRA arbitration panels award damages against broker-dealers for "failing" to fulfill this invented supervisory obligation. This liability built upon fiction creates precisely the kind of regulatory entanglement that undermines the distinct regulatory frameworks Congress established.

Notably, after the Spire case in 2018, FINRA briefly acknowledged the boundary problems by proposing a rule that would "ease brokers' supervisory requirements for the work their reps do at unaffiliated RIAs"—an implicit admission that its current approach exceeds proper jurisdictional limits. Yet FINRA now seeks to retain this overreach in the new consolidated rule, despite having previously recognized its impropriety.

DUE PROCESS VIOLATIONS

Congress deliberately placed investment adviser regulation under a statutory framework with specific enforcement mechanisms and due process protections. Yet FINRA's supervision requirements subject broker-dealers to FINRA's own disciplinary system for matters concerning investment advisory activities—activities explicitly placed outside FINRA's jurisdiction. This usurpation represents a fundamental denial of due process, as firms face FINRA disciplinary actions and arbitration liability for advisory activities that should be addressed solely through the enforcement mechanisms Congress established in the Investment Advisers Act.

FINRA's disciplinary procedures and arbitration system lack many of the due process protections available in federal courts and SEC administrative proceedings. By bootstrapping advisory supervision into FINRA's jurisdiction, broker-dealers are forced into a forum with fewer procedural safeguards than Congress intended for matters related to investment advice. This "camel's nose under the tent" approach allows FINRA to subject firms to enforcement mechanisms Congress never authorized for investment advisory matters, circumventing the specific enforcement regime established by statute.

TROUBLING REGULATORY RELATIONSHIPS

A concerning dynamic underlying FINRA's persistence in maintaining this jurisdictional overreach is its relationship with the Public Investors Advocate Bar Association (PIABA). PIABA, whose members directly benefit from the expanded liability created by FINRA's supervision mandate through increased arbitration awards against broker-dealers, has vigorously opposed any attempts to limit this supervisory requirement. One cannot help but question whether FINRA maintains this legally questionable rule as a concession to PIABA's interests, effectively allowing plaintiff's attorneys to pursue recovery against broker-dealers for investment advisory activities that should be beyond FINRA's jurisdiction.

FINRA's arrangement with PIABA creates a troubling regulatory capture scenario where FINRA appears beholden to special interests rather than adhering to its statutory limitations. The Spire Securities case illustrates precisely how this dynamic works to the advantage of PIABA members: an arbitration panel issued a \$3 million award against a broker-dealer for failing to supervise an independent adviser's activities—activities occurring entirely outside the broker-dealer framework that Congress established FINRA to regulate.

FINRA appears to be maintaining rules that exceed its statutory authority in a manner that directly benefits PIABA members through expanded arbitration recovery opportunities. But for FINRA's improperly imposed "duty to supervise," broker-dealers would have no requirement to oversee external RIAs, and plaintiffs would have no basis to sue broker-dealers for activities occurring entirely outside the broker-dealer relationship.

FINRA's refusal to properly limit its rules to its statutory jurisdiction, despite briefly acknowledging these boundary issues in 2018, suggests that its regulatory approach may be influenced more by accommodating PIABA's interests than by respecting the legal framework established by Congress. This raises serious questions about FINRA's regulatory independence and its willingness to maintain rules that exceed its authority to benefit a specific constituency within its ambit.

HISTORICAL CONTEXT OF FINRA'S LIMITED AUTHORITY

FINRA's jurisdictional overreach becomes even more apparent when we recall its fundamental origins and intended purpose. FINRA (formerly NASD) was essentially created as the regulatory desk of the NASDAQ stock exchange, granted authority in the 1930s solely to regulate the activities of market participants on the over-the-counter exchange. It was never conceived or authorized by Congress to have any oversight of investment advisory activities, which are governed by an entirely separate statutory framework established in 1940.

This historical context is crucial—FINRA's authority stems from a specific, limited mandate to regulate broker-dealer activities related to securities exchanges. Congress deliberately created a separate regulatory regime for investment advisers with the Investment Advisers Act of 1940, intentionally placing advisory activities outside the purview of the exchange-focused regulatory body. FINRA's attempt to regulate investment advisers through supervision requirements represents not just a technical overreach but a fundamental departure from its original purpose and limited statutory authority.

DISTINCT STATUTORY FRAMEWORKS

More specifically, FINRA's jurisdiction is found exclusively within the Securities Exchange Act of 1934, which governs secondary market transactions. This legislation was designed to regulate broker-dealers and the trading of securities in the secondary market, not the provision of investment advice. Six years later, Congress enacted the Investment Advisers Act of 1940 as a separate and distinct regulatory framework specifically tailored to investment advisory services. This deliberate separation by Congress created two different regulatory regimes with different purposes, standards, and oversight mechanisms.

By attempting to regulate investment advisers through its supervision requirements, FINRA is not only exceeding its authority but effectively trying to bridge a statutory gap that Congress intentionally created. The 1934 Act's focus on secondary market transactions on an exchange provides FINRA no legitimate basis to reach into advisory relationships governed by the 1940 Act. This statutory distinction forms the fundamental legal basis for why FINRA's supervision requirements for outside RIAs are ultra vires—they represent an attempt to regulate activities that fall completely outside the bounds of the legislation from which FINRA derives its authority.

UNDERMINING SEC AUTHORITY

FINRA's supervision requirements don't merely exceed its own jurisdiction—they actively undermine the SEC's congressionally granted authority over investment advisers. Congress deliberately placed investment adviser oversight under the SEC through the Investment Advisers Act of 1940, creating a specific regulatory framework with its own standards, examinations, and enforcement mechanisms. By imposing a parallel, unauthorized supervisory structure through broker-dealers, FINRA effectively creates a shadow regulatory system that interferes with and duplicates the SEC's statutory role. This represents a troubling encroachment not just on adviser independence but on the SEC's explicit congressional mandate and regulatory prerogatives. Such interference creates confusion about which standards apply and dilutes the SEC's ability to implement its regulatory approach as Congress intended.

ANTI-COMPETITIVE EFFECTS

FINRA's supervision mandate has significant anti-competitive implications that harm both financial professionals and the investing public. By imposing substantial compliance costs on

broker-dealers for supervising activities outside their core business, these requirements disproportionately burden smaller and mid-sized firms that lack the resources to implement expansive supervision programs. This artificially advantages larger institutions while driving industry consolidation by making hybrid business models economically unfeasible for all but the largest firms.

The anti-competitive nature of these requirements is particularly troubling because they effectively force many independent advisers to either abandon their broker-dealer relationships entirely or surrender their independence to larger corporate entities. This was never Congress's intent when establishing separate regulatory frameworks. Rather than promoting a diverse financial services marketplace where various business models can compete fairly, FINRA's overreach effectively tilts the playing field toward large institutions—reducing consumer choice, limiting business model innovation, and potentially increasing costs for investors who lose access to independent advice.

CONCLUSION

FINRA's expansion into investment adviser regulation isn't merely an incremental extension of authority—it's a wholesale breach of the distinct regulatory boundaries Congress established. As an SRO whose authority derives from the Exchange Act, FINRA simply has no legitimate basis to create rules that regulate activities Congress explicitly placed under a different regulatory framework.

FINRA's decades-long, multi-million-dollar lobbying campaign to gain regulatory control over investment advisers, combined with arbitration decisions like *Spire* that create liability beyond statutory boundaries, reveal a coherent strategy to exercise de facto control over a space Congress intentionally placed beyond FINRA's reach.

I strongly urge FINRA to remove all provisions in the proposed rule that require supervision of outside IA activities. FINRA should limit the scope of its rules to areas within its statutory authority and recognize the separate regulatory framework established by Congress for investment advisers.

Thank you for your consideration of these concerns.

ANONYMOUS