

## **Comment Letter on Regulatory Notice 26-02**

### **Re: Proposed Amendments to Rules 4512 and 2165 and Proposed Rule 2166**

Dear FINRA:

I appreciate the opportunity to comment on Regulatory Notice 26-02 and FINRA's continued efforts to modernize its framework for protecting investors from financial exploitation and fraud.

I submit this comment based on prior service at FINRA and my current work analyzing supervisory responses in matters involving suspected exploitation, fraud, and account compromise. That experience provides insight into how FINRA rules function in examinations and how regulatory frameworks are later interpreted in adversarial proceedings. I offer the following observations to support consistent and practical application.

Overall, the tools provided by Rules 4512 and 2165, and the proposed addition of Rule 2166, represent meaningful mechanisms for investor protection. The flexibility embedded in these rules is appropriate. Firms must retain discretion to evaluate the totality of facts and circumstances. At the same time, additional clarification in certain areas may help ensure that regulatory intent and practical application remain aligned.

#### **1. Clarifying the Reasonable Belief Standard**

The concept of a reasonable belief is central to Rule 2165 and to proposed Rule 2166. While the rule identifies a reasonable belief as the prerequisite threshold in order to rely on its provisions, the rule does not define what the reasonable belief *is* nor does it establish a standard for *when a reasonable belief exists*.<sup>1</sup> Its flexibility is important, but in practice the absence of clearer articulation regarding what that threshold is and when that threshold is met can create interpretive tension.

In examinations, firms frequently describe layered supervisory systems designed to detect and escalate red flags of exploitation or fraud. In post-loss disputes, however, I have observed arguments that no obligation to escalate or intervene existed unless and until the firm formed a *formalized* reasonable belief sufficient to trigger a temporary hold under Rule 2165. In some

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<sup>1</sup> Other regulatory frameworks demonstrate that it is possible to define when a reasonable belief shall exist while preserving flexibility. For example, certain state statutes addressing suspected financial exploitation articulate the standard as arising when a person observes behavior, unusual circumstances, and/or transaction patterns that would lead an individual with similar training or experience, based on the same facts, to form a reasonable belief that exploitation has occurred or is occurring.

The specific purposes and statutory context of those provisions differ from FINRA's application here, and I only include such formulations to illustrate how a standard can be expressed in objective terms, tied to how a similarly situated professional would evaluate the same facts, without mandating a particular action in every instance. Providing similar conceptual clarity within the FINRA framework may help reduce interpretive ambiguity while preserving appropriate discretion.

matters, the existence of a reasonable belief is framed as having arisen only if the firm chose to act, treating it retrospectively and outcome dependent rather than as a part of an ongoing supervisory process under FINRA Rule 3110(c)(2).

Providing illustrative guidance regarding factors that may contribute to the formation of a reasonable belief could promote greater consistency. Such guidance need not mandate specific actions, but could describe circumstances that, individually or collectively, may support escalation or protective review. Examples might include sudden changes in account profile information in proximity to disbursement requests, unexplained behavioral deviations from historical patterns, involvement of unfamiliar third parties, acknowledged scam narratives, or internally identified transaction anomalies.

## **2. Safe Harbor and Broader Regulatory Responsibilities**

Clarifying that the reasonable belief analysis operates within a broader supervisory framework may reduce the risk that the rule's permissive structure is read to diminish existing responsibilities in the presence of documented red flags. Even if FINRA elects not to further define when the threshold is met, it may be helpful to reiterate how Rules 2165 and proposed 2166 interact with firms' independent supervisory, AML, and Regulation S-ID obligations.

The availability of a safe harbor should not create ambiguity as to whether the absence of a temporary hold relieves a firm of duty to respond that might arise under other non-permissive regulatory frameworks.<sup>2</sup> Those frameworks are not structured as permissive safe harbors in the same manner as Rule 2165, nor proposed Rule 2166.

For example, the same underlying facts that may not result in a temporary hold can nevertheless trigger internal risk or surveillance alerts, supervisory review considerations under Rule 3110, Reg S-ID, or anti-money laundering escalation analysis.

## **3. Proposed Rule 2166 and the Five Business Day Delay**

### **A. Clarifying Scope in Potentially Unauthorized Transaction Scenarios**

Proposed Rule 2166 permits a temporary delay of up to five business days where there is a reasonable belief of fraud targeting a customer. The rule appears primarily designed to address fraudulent inducement, where a customer may be authorizing a transaction under deceptive influence.

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<sup>2</sup> For example, some circumstances might nevertheless require intervention under the obligation of Reg S-ID to detect, prevent and mitigate identity theft.

It may be helpful for FINRA to clarify whether Rule 2166 is intended to apply in circumstances where the transaction itself may be unauthorized, such as potential account compromise, credential manipulation, or interception of authentication controls.

In unauthorized transaction scenarios, the issue may not be whether the customer can be persuaded to reconsider a transaction, but whether the firm has a reasonable basis to question whether the transaction was authorized at all. Clarification regarding the intended scope of Rule 2166 may help prevent interpretive confusion, particularly where firms confront indicators of account takeover or compromised communication channels.

## **B. Five Business Day Delay and Unresolved Risk Conditions**

Proposed Rule 2166 establishes a five business day delay absent extension by a regulator or court. In many circumstances, that period may be sufficient.

However, fraud risk does not always resolve within a fixed timeframe. The passage of five business days does not necessarily resolve underlying questions regarding inducement or manipulation. If the condition that prompted the delay remains unresolved, the protective purpose of the delay may not yet have been fulfilled.

For example, in refund scams or imposter scams, a customer may be instructed by a bad actor posing as a government agency, financial institution, or law enforcement authority to transfer funds to protect assets or assist with a purported investigation. In some instances, account activity may also reflect digital login anomalies consistent with remote desktop access or account takeover, yet the customer may nevertheless participate voluntarily because they believe they are preventing fraud.

In these circumstances, apparent authorization does not necessarily eliminate the possibility that the transaction is the product of manipulation. The expiration of the five business day delay should not be interpreted as resolving the underlying concern if credible indicators of inducement remain present or if new indicators surface because of those interactions with the customer.

Where a transaction remains subject to ongoing review due to unresolved risk conditions, the ability to have a narrowly tailored and documented delay extension tied directly to addressing those concerns may better advance the investor protection objective than automatic release based solely on elapsed time.

The guiding principle should remain reasonableness and proportionality. Additionally, a time-based mechanism should not be interpreted as limiting a firm's responsibility to act on the results of its investigation under applicable supervisory frameworks.

### **C. Evaluating Customer Responses During the Intervention Period**

The Notice explains that the purpose of the temporary delay is to alert the customer to suspected fraud and persuade the customer not to proceed with the transaction. To achieve that objective, the intervention process must meaningfully assess whether the customer's authorization reflects independent intent or ongoing manipulation.

In inducement-based scams, customers often do not recognize that they are being deceived. They may respond to verification inquiries with confidence, repeating the narrative provided by the bad actor. In such circumstances, the relevant inquiry is not solely what the customer believes, but how that belief was formed.

For example, in relationship-based investment scams, including those commonly described as "pig butchering" schemes, a customer may express strong trust in the individual who introduced the investment opportunity. The fact that the customer believes they know or trust the person is not, by itself, dispositive. In such scams, a customer's unequivocal affirmation that they "know" or "trust" the individual is often the predictable product of the very conduct the rule is designed to interrupt. If the intervention process ends there, the delay serves a procedural function but not a protective one. How the relationship was initiated and developed, including whether it originated online, through social media, or through unsolicited contact, may be critical to assessing whether the opportunity is legitimate or part of an imposter scheme.

Customers generally lack visibility into broader fraud patterns, including the use of applications or platforms designed to mimic legitimate investment services. What appears credible based on limited interaction may reflect recognizable scam attributes from the firm's vantage point.

It may therefore be helpful for FINRA to remind firms that the intervention period should not be reduced to a rote exchange of verification questions. Where red flags remain, firms may need to engage in contextual dialogue that explains the basis for concern and explores how the transaction and any related relationship were formed. The objective is not merely to document confirmation, but to assess whether the customer's decision is informed and free from fraudulent influence.

Reinforcing that the temporary delay is intended as a substantive protective tool rather than a procedural checkpoint may help ensure that the rule functions as designed.

### **4. Trusted or Emergency Contact Framework**

The proposal to permit the use of the term emergency contact may increase customer comfort and participation. Greater adoption of this safeguard is likely beneficial.

Consideration could also be given to allowing more than one designated contact. In exploitation matters, a single contact may be unavailable, unreachable, or otherwise unable to assist. Allowing

multiple contacts, while preserving customer choice and control, may enhance the practical effectiveness of this protective measure.

### **Conclusion**

The proposed amendments and the introduction of Rule 2166 reflect FINRA's ongoing commitment to addressing the evolving threat landscape facing investors. The flexibility built into these rules is appropriate and should be preserved.

Additional clarification regarding the reasonable belief standard, the interaction between safe harbor provisions and independent supervisory obligations, the scope of proposed Rule 2166, and the design of meaningful intervention processes may strengthen consistent application and further advance investor protection.

I appreciate FINRA's consideration of these observations and its continued engagement with industry participants to enhance investor protection.

Respectfully submitted,

A handwritten signature in black ink that reads "C. Mustico". The signature is written in a cursive, flowing style.

Catherine Mustico, CFE, CAMS, CAMS-FCI