The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

May 13, 2025

Via e-mail to pubcom@finra.org

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

Re: Comments in Opposition to Proposed Rule 3290. Outside Activities

Dear Ms. Mitchell:

I am writing in my capacity as the chief securities regulator for Massachusetts to oppose FINRA's proposed Rule 3290 (the "Proposed Rule"). As explained in Regulatory Notice 25-05 (the "Notice") the Proposed Rule would overhaul and merge the frameworks for member supervision of outside business activities ("OBA") and private securities transactions ("PS"). As FINRA marks 85 years of protecting investors, the changes set out in the Proposed Rule Notice are decidedly a step back. I urge FINRA to reconsider the Proposed Rule in its current form because it would establish reduced standards and oversight, to the detriment of investors and savers.

As I commented in 2018, when FINRA proposed a similar rule change, investor protection is a responsibility that is shared by regulators and industry participants.[1] It is noteworthy that in response to previous attempts to redefine and consolidate OBA and PST rules, certain members and industry organizations called to retain the existing rules on OBA and PST. In fact, at least one industry commenter recognized the holistic role broker-dealers play in safeguarding the savings of Main Street investors. This is a realistic position, because clients are likely to view the different kinds of services they receive from firms or associated persons as connected.

[1] https://www.finra.org/rules-guidance/notices/18-08/comment/commonwealth-massachusetts-comments-regulatory-notice-18-08

There have been no industry or regulatory developments that alter my concerns about how investors will be protected by the removal of supervisory oversight in these areas. Such oversight is at the core of any well-run compliance apparatus. Unfortunately, my office continues to receive complaints and take action concerning the harmful conduct of FINRA member firms and their agents in the absence of reasonable supervision, including misconduct in connection with OBAs and PSTs.

1. Investor Protection Requires Broker-Dealer Supervision of Investment Adviser and Affiliate Activity.

FINRA should not move away from its current framework mandating member supervision of an agent's participation in PSTs involving investment advisory accounts. Removing such basic investor protection requirements would increase investor exposure to unethical and dishonest business practices.

In fact, my office recently resolved allegations concerning a Massachusetts registered broker-dealer in connection with leveraged and inverse leveraged ETF transactions effected by individuals who were dually-registered as both broker-dealer agents and investment adviser representatives. In this case, the broker-dealer failed to detect, and therefore review, transactions effected by its Massachusetts agents. In total, the broker-dealer failed to review the suitability of thousands of leveraged exchange-traded fund transactions executed by its dually-registered agents in the accounts of Massachusetts investors. As a result of supervisory failures, Massachusetts investors—often holding short-term leveraged ETF positions for periods in excess of one-year—experienced significant losses. Based on these failures in supervision, investors were offered restitution and my office required the firm to enhance its supervisory practices.

The artificial line that the Proposed Rule attempts to draw between unaffiliated and affiliated investment advisers, is an attempt to find a distinction where none exists. Affiliation alone does not assure investor protection. While there may be greater cooperation and ease of record sharing between affiliates, it is just as possible that an affiliate may have less stringent compliance than a non-affiliate.

The Proposed Rule would create significant conflict of interest concerns by excluding affiliate transactions. Such exposure is especially concerning given Massachusetts' fiduciary duty rule and its requirements concerning a broker-dealer and agent's review of conflicts. While it may be true that broker-dealers and investment advisers compete for customers and clients based on similar skill sets, it is absolutely not the case that these individuals are subject to fiduciary requirements outside of Massachusetts. Thus, given that fiduciary standards do not govern the activities of these registrants in most jurisdictions, it is necessary for broker-dealer firms to have increased disclosure and review responsibilities in order to protect investors.

2. Limiting Outside Activities to Only Those Defined as Investment Related Is Too Narrow.

The Proposed Rule's narrowing of mandated OBA notice to "investment-related activity" overlooks wide swaths of OBA activity that are likely to cause investor harm. A broader

definition is necessary to ensure supervision is evergreen and able to evolve with regulatory requirements governing broker-dealer conduct—including Massachusetts' fiduciary duty rule.

The Proposed Rule's limited subset of practices critically excludes consulting, legal, tax, and marketing functions, as well as accountancy and financial control positions that can be precursors to larger fraudulent activity—and all of which occupy positions of trust relied upon by investors. A system that has no reporting requirement for activities that are "not investment-related" leaves it up to the associated/registered person to determine what they need to report. This opens a Pandora's Box of characterization risk and, at a minimum, creates a blind spot concerning what registered persons may be doing outside of the member.

My office's recent action against a broker-dealer in connection with its supervision of an agent's OBA demonstrates that notice of and supervision over a broader set of outside activities is needed to protect investors. In this case, the failure of the broker-dealer to conduct reasonable supervision of the agent's OBA left undetected a multi-million dollar fraud stemming from an agent's OBA. The member firm failed to reasonably review outside business activities conducted by the agent – purportedly a "marketing" entity. For nearly 30 years, spanning multiple broker-dealers, the agent defrauded his clients by creating fake account statements and invoices under the guise of the marketing arm. Under the Proposed Rule, such conduct would go underreported at best and unreported at worst.

The Proposed Rule would also exclude or inject unnecessary discretion as it pertains to some of the market's highest-risk assets and products, which are often replete with conflicts. These include non-fungible tokens, event contracts, tokenized securities, credit cards, and loans (including reverse mortgages), and collectibles, among others. These products represent the fringe of assets available to retail investors. These products are replete with risk, are often misunderstood by retail investors, and are typically expensive. As such, they should be subject to multiple layers of oversight. These products would benefit from ongoing supervision to prevent inappropriate cross-selling efforts. Further, FINRA member firms with affiliated entities, including crypto and commodity partners, should not be exempt from supervision standards to ensure that products that may be cross-sold will be in the best interest of its customers.

3. The Exception for Outside Business Activities Is Too Broad.

The Proposed Rule is also problematic in its exclusion of portfolio managers and investment committee members. If the broker-dealer approves the activity, it would not be required to supervise and maintain records for an associated person who is acting as a portfolio manager or investment committee member for registered investment companies, unregistered investment companies, business development companies, real estate investment trusts, and entities that are recognized as tax exempt, unless the associated person is selling such entities' shares for selling compensation.

In these roles, an associated person may be subject to a range of conflicts. In some cases, the associated person could have fiduciary duties to the fund and its investors. In the context of a tax-exempt organization, there may be risks and conflicts that could harm the organization.

There should not be a *per se* exclusion of these activities from the requirements to supervise and maintain records.

In the end, the Proposed Rule is a solution in search of a problem. I urge FINRA to reconsider the degree to which the Proposed Rule would absolve FINRA's member firms of supervisory obligations needed to protect investors. Please contact me or Anthony R. Leone, Deputy Secretary of the Commonwealth, at 617-727-3548 if you have questions or we can assist in any way.

Sincerely,

William F. Galvin
Secretary of the Commonwealth
Commonwealth of Massachusetts