



VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

June 29, 2017

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

Re: Regulatory Notice 17-20: FINRA Requests Comment on the Effectiveness and Efficiency of Its Rules on Outside Business Activities and Private Securities Transactions

Dear Ms. Mitchell:

On May 17, 2017, the Financial Industry Regulatory Authority (FINRA) published a request for public comment on its rules governing outside business activities¹ (OBAs) and private securities transactions² (PSTs) to assess the effectiveness and efficiency of the rules (Regulatory Notice).³ The Regulatory Notice begins the first phase of a retrospective review to determine whether those rules are efficiently meeting their intended investor-protection objectives. The Regulatory Notice seeks input from stakeholders regarding the rules' substance, application and the process FINRA uses to administer them. The Regulatory Notice also invites suggestions as to how the rules should potentially be changed through any subsequent rulemaking.

The Financial Services Institute⁴ (FSI) appreciates FINRA's efforts to reexamine existing rules to ensure that they are achieving their intended purpose. FSI and its members believe that retrospective review of existing rules is essential to smart, efficient regulation. Independent financial advisors' ability to provide services in areas that are often outside the traditional role of a financial advisor – such as tax and accounting, insurance, and estate planning – is a large part of the value the independent model offers investors, especially those who live in smaller communities where other options for accessing these services may be limited. We provide more specific feedback in the comments below.

¹ FINRA Rule 3270. Outside Business Activities of Registered Persons *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9467

² FINRA Rule 3280. Private Securities Transactions of an Associated Person *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=12012

³ See Regulatory Notice 17-20, *available at* https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-20.pdf.

⁴ The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives.⁵ These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners with strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate \$48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.⁶

Discussion

FSI appreciates the opportunity to participate in this retrospective rule review in order to provide our members' insights and experience with the substance, application and administration of the OBA and PST rules. We applaud FINRA's examination of these rules to assess whether they remain effective in accomplishing their intended goals. The current regulatory framework for OBAs and PSTs seeks to protect investors from potentially fraudulent or risky activities by financial advisors. Firms' compliance with the requirements serve to not only protect their investing clients but also to protect the firm itself from reputational and litigation risks. The current broad scope of the OBA rule in particular allows firms to implement a system to assess and monitor OBAs that is tailored to their unique business needs. However, we offer a few suggestions that could make the administration of the OBA rule more efficient.

A. Create an Insurance Carve-Out

FINRA Rule 3270 prohibits a registered representative from conducting "any business activity outside the scope of the relationship with his or her member firm, unless he or she has

⁵ The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

⁶ Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

provided prior written notice to the member, in such form as specified by the member.”⁷ Thus, registered representatives are required to notify their associated firm of all activities for which they receive compensation prior to engaging in those activities. Firms then conduct a review of the proposed OBA through a risk-based analysis. The purpose of the review is to ensure that the OBA poses no harm to the investing public, such as potential conflicts of interest or illegal behavior perpetrated through the unsupervised business. While the rule does not require firms to approve the proposed OBA, as a practical matter nearly all broker-dealers’ required written supervisory procedures⁸ require an associated person to receive firm approval before conducting an OBA.

As currently drafted, the rule requires broker-dealers to closely examine any outside business activity that is financial in nature (e.g., insurance sales, investment advice, mortgage brokering, real estate agent, CPA, estate planning attorney, etc.). As discussed earlier in this letter, independent financial advisors play a pivotal role in delivering financial services to middle-class Americans. FSI members make a disproportionately large economic contribution to communities that are traditionally underserved by other segments of the financial services industry.⁹ Advisors affiliated with an IBD generally focus on holistic financial planning services and often provide insurance products as part of those services. Because these services are already regulated by another entity and disclosed in almost every representative’s Form U4, there is little risk of the type of investor harm the rule is intended to mitigate. Thus, we suggest creating a carve out for insurance activity that is already reported, creating a carve out for products that are clearly insurance-only products, or adding a line to the Form U4 disclosing insurance affiliations. This would ensure that advisors are disclosing insurance activities, but removes the need to place additional conditions and limitations on advisors that result in little additional investor protection.

B. Impose an Ongoing Duty to Inform Broker-Dealers of Material Changes

We believe Rule 3270 should impose a specific obligation on financial advisors to inform their broker-dealer of material changes to the nature of their outside business activity. This will ensure that the broker-dealer has the necessary information to make informed decisions about the financial advisor’s continued involvement in the activity or the need to impose new conditions or restrictions with respect to the activity. In item 15A.9 on the Form U4, an applicant agrees to amend the form whenever changes occur to the information previously reported “on a timely basis.” Requiring advisors to update their OBA information on the same timeline allows firms to adequately monitor that activity. We recognize the challenge of determining what would constitute as a “material change” and would welcome the opportunity to discuss with FINRA how this may be helpfully defined based on FINRA’s experiences with examining firms for OBA compliance.

We also suggest that either Rule 3270 or its supplemental material be updated to clarify that member firms are not required to supervise OBAs. Both the previous NASD Rule 3030 and FINRA Rule 3270 require representatives to notify firms before engaging in an OBA. Guidance

⁷ See FINRA Rule 3270, available at http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=9467

⁸ FINRA Rule 3110 requires a firm to establish and maintain a system to supervise the activities of its associated persons that is reasonably designed to achieve compliance with the applicable securities laws and regulations and FINRA rules.

⁹ *Oxford Economics supra* note 6 at 21.

on Rule 3030¹⁰ explains that firms are not required to supervise or even approve an OBA, but it may choose to deny or place conditions on the activity. Because FINRA Rule 3270 has replaced NASD Rule 3030, we ask for similar guidance under the current rule.

C. Provide Updated Guidance on Registered Investment Advisors as OBAs

Advances in technology have changed the financial services industry significantly since the OBA rules were put in place. The dually registered¹¹ broker-dealer/registered investment adviser is the fastest growing group within financial advisory services. From 2008 to 2013, the number of dually registered investment advisors (RIAs) increased by 50% to more than 24,000.¹² RIAs are expected to become even more prevalent in light of the Department of Labor's Fiduciary Rule requirements. FINRA has not updated its guidance related to the OBAs of outside RIAs since 1996. The industry has significantly changed in those 21 years, but the lack of updated guidance has created confusion for firms as to the supervisory responsibilities firms must undertake when dealing with outside RIAs. Firms report that regulators have also been taking a closer look at outside RIAs during exams, and comparing them to the corporate RIA and looking for discrepancies. Firms are unsure how to treat outside RIA client information because these individuals are not in fact their clients for advisory services, but regulators are treating them as such. FSI member firms would appreciate some clarification and guidance on this issue and look forward to providing more specific input during a potential rulemaking.

Conclusion

OBAs are a vital component of the value independent financial advisors offer to their clients and communities and FSI is pleased that FINRA is reviewing existing rules to help ensure their ongoing effectiveness. We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,



David T. Bellaire, Esq.
Executive Vice President & General Counsel

¹⁰ FINRA Notice to Members 05-50 (August 2005) available at <http://www.finra.org/sites/default/files/NoticeDocument/p014821.pdf>

¹¹ In this case, the term dually registered refers to a registered representative who is affiliated with an RIA affiliate of their broker-dealer.

¹² See http://www.falllinesec.com/files/pdfs/FallLine_Rise_Hybrid_Advisor_2015.pdf.