

Comment submitted by Bill Singer, Esq., publisher of the:

- BrokeAndBroker.com Blog <http://www.brokeandbroker.com/brokeandbroker.com>], and
- Securities Industry Commentator feed <http://www.rrbdlaw.com/blog.php/rrbdlaw.com>] and

NOTE: For purposes of this Comment, “OBA” stands for “Outside Business Activities” and “PST” for “Private Securities Transactions.”

As set forth in “Notice to Members 18-08 (February 26, 2018): Outside Business Activities/ FINRA Requests Comment on Proposed New Rule Governing Outside Business Activities and Private Securities Transactions,” proposed *FINRA Rule 3290. Outside Business Activities* should include a substantive reference to <http://www.finra.org/industry/interpretive-letters/december-6-2001-1200am> (the “December 6, 2001 NASD Interpretive Letter”).

As noted in the *December 6, 2001 NASD Interpretive Letter*, my former law firm sought:

advice on whether a registered person who is associated with a member firm would violate NASD Rule 3030 - Outside Business Activities of an Associated Person by filing a membership application with the NASD to form a new broker/dealer without providing prompt written notice to his or her firm about such activity.

In seeking NASD’s guidance, my law firm presented the following scenario to FINRA’s predecessor:

XYZ BD currently employs RR Doe. While still working for XYZ, RR Doe submits an application seeking approval to open NEW BD (with RR Doe filing a Form U-4 as an associated person and principal of the new firm). During this nascent stage, no business is being conducted at NEW BD and RR Doe currently receives no compensation from the new firm. Additionally, at this stage RR Doe is not engaged in activity that is in actual conflict or competition with XYZ BD. Given that NEW BD has not commenced a securities business, RR Doe does not believe that the mere application for and subsequent approval of NEW BD places her current BD employer at any regulatory or arbitration risk.

As noted in *December 6, 2001 NASD Interpretive Letter*, I acknowledged that:

the raising of capital for a broker/dealer would likely trigger the notice/approval requirements of the private securities transaction provisions of NASD Rule 3040 - Private Securities Transactions of an Associated Person.

In response to my law firm’s query, the *December 6, 2001 NASD Interpretive Letter* stated, in pertinent part that:

Under the facts as you have described them in your letter, the staff believes that the notice requirements of NASD Rule 3030 are not triggered when, in an effort to apply for membership as a new broker/dealer, an associated person takes the following steps: (1) forms a company; (2) files an application on behalf of the company to become a member in accordance with NASD Rule 1013; and (3) files a Form U-4 with NASD designating such associated person as a

principal of such company; provided, however, the associated person does not (1) accept any compensation from such company or other person (other than compensation received from the current member firm with which he or she is associated) ; (2) engage in any securities or investment banking activity on behalf of such company; (3) raise capital for such company; (4) solicit customers for such company; or (5) generally engage in any business activity on behalf of such company.

During our phone conversations, you noted that the new membership application process requires RR Doe to file a Form U-4 as an associated person and principal of the applicant broker/dealer, and that the Central Registration Depository ("CRD") system discloses the filing of this Form U-4 (i.e., the associated person's current member firm could search the individual's records and see the filing of the second Form U-4). You raised some concern that this disclosure could have a potentially negative impact on RR Doe. Staff of the Office of General Counsel is discussing your concerns with staff in the CRD Department, as well as with staff in the Department of Member Regulation responsible for the membership application program.

Some 17 years later, the concerns raised in my 2001 inquiry to NASD are still extant. With the apparent demise of the *Broker Protocol*, large FINRA member firms will likely increasingly resort to litigation against former employees who open their own broker-dealers ("BDs") or registered investment advisors ("RIAs"). Similarly, there are reports of member firms imposing expansive non-solicitation and non-compete clauses within their standard affiliation agreements. As such, it is an increasingly sensitive issue as to what constitutes, on the one hand, the mere "preparation" to engage in business (which should not require an industry employee to disclose such efforts to a member firm) versus, what constitutes, on the other hand, conduct that FINRA should legitimately deem as an activity or transaction requiring OBA/PST disclosure.

I wholeheartedly embrace the rationale for OBA/PST regulation. Notwithstanding, FINRA has arrogated the power to approve new rules solely to its employer member firms, and in so doing, has disenfranchised the industry's men and women. Given that lack of input and voice, FINRA must not become a tool of its employer firms by providing cover for anti-competitive and retaliatory employment practices under the guise of regulation. Employees of FINRA's member firms should be allowed - and I would even argue "encouraged" - to pursue their entrepreneurial dreams. To the extent that employees open their own BDs or RIAs, that is the byproduct of a robust, free-market economy that should be celebrated on Wall Street of all industries!

FINRA should not require registered persons to notify their member firms of a mere "intention" or "preparation" to open their own BD or RIA. Requiring such "premature" notice to an employer is an invitation for the employer to engage in anti-competitive and retaliatory efforts to derail or hamper the employee's proposed venture. FINRA has the right to require prior written notice when a registered person intends to begin substantive BD/RIA activities in furtherance of fundraising and/or engaging in business. Activities that are generic to merely creating an entity or preparing to engage in a business, however, should not trigger the proposed *FINRA Rule 3290* prior notice requirement.

Upon learning that a registered person has filed a Form BD/ADV or a FINRA membership application, a member firm may prefer to terminate such employees. Under the state law "terminable at will" employment doctrine, many industry employers have the discretion to fire their employees for virtually any legal reason. Similarly, there are many remedies found in breach of contract or tort law that provide legal recourse for member firms aggrieved by allegedly improper conduct attendant to a former employee's departure or efforts to solicit

customers. Proposed *FINRA Rule 3290* invites industry employers to cynically ascribe the termination of such employees to “potential regulatory violations,” which has the result of raising concerns and engendering approval delays when FINRA or a state agency may review those individuals’ pending BD/RIA applications. In alleging such a regulatory violation, an employer would not be raising a bona fide concern but simply trying to hamstring the perceived new competition and/or gain an edge in the ensuing battle for customers.

In closing, I urge FINRA to incorporate the *December 6, 2001 NASD Interpretive Letter* into the final version of proposed *FINRA Rule 3290* and to provide clear guidance as to what OBA/PST “activity” attendant to launching a BD/RIA triggers a regulatory obligation to notify an employer.