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April 26, 2018

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 18-08
FINRA Requests Comments on Proposed New Rule Governing Outside Business Activities and Private Securities Transactions

Dear Ms. Mitchell:

I am submitting this letter in response to the request by FINRA for comments on a proposed new rule ("the Proposal") to address outside business activities and private securities transactions.

Briefly, by way of background, I am currently employed as Managing Director by a consulting firm that provides regulatory and compliance consulting services to broker-dealers and investment advisers. In that role, among other responsibilities, I provide consulting and support to all segments of the financial services industry, including major broker-dealers across the country.

Previously, I was employed by the NASD as Executive Vice President. In that position, prior to its reorganization in 1996, I had responsibility for all of the NASD's examination, surveillance and enforcement programs. I was employed by NASD for almost 28 years, and as Executive Vice President, I reported directly to the NASD President. Among my other responsibilities, I was also very actively involved in the development of various rules, including those addressing private securities transactions and outside business activities. Initially, these rules were Article III, Sections 40 and 43, respectively, of the Rules of Fair Practice. So, I have great familiarity with the reasoning behind the adoption of these rules and their application. I have also testified as expert witness in numerous arbitrations and civil litigations involving private securities matters.

With that as background, I would like to share some of my thoughts on the Proposal. The comments in this letter are my own, and do not represent the opinions of my employer.

Let me say I am totally supportive of FINRA's efforts through its retrospective rule review program, and with the stated intention in the Proposal to reduce unnecessary burdens on members while strengthening protections for the investing public. While I believe the Proposal has generally achieved these objectives, there are some aspects of the Proposal where I am concerned investor protection may have been negatively impacted.

Let me start with the focus of the Proposal solely on registered persons, while the current Rule 3280 deals with associated persons. Why is it any less of a regulatory concern if a non-registered person gets involved in private securities transactions? True, they are not dealing with their firm's customers, but quite often, private securities activity does not involve a firm's clients, but rather other unsuspecting members of the public, including affinity groups, seniors and a host of others who are lured into these schemes. From a regulatory and litigation risk perspective, if/when these outside investments turn out to be Ponzi schemes or other frauds, harmed customers/claimants invariably look to the broker-dealer for relief. So, FINRA members should be aware of any of their employees intending to engage in private securities transactions. Therefore, in light of the serious nature of this issue on investor protection, I believe the Proposal should encompass all associated persons when it involves private securities activity.

With regard to the proposal to exclude "buying away" from the rule, I do not see how this enhances investor protection. FINRA Rule 3210 and its predecessor Rule 3050, prohibits any associated person, without the prior written consent of the member, to open or otherwise establish at a member other than the employer member, or at any other financial institution, any account in which securities transactions can be effected and in which the associated person has a beneficial interest. The employer member must determine whether it will be able to obtain, upon written request, duplicate copies of confirmations and statements, or the transactional data contained therein, directly from the other financial institution in determining whether to provide its written consent to an associated person to open or maintain such account. One of the reasons for this requirement is for the employing member to be aware of the securities activities of its associated persons being executed at another financial institution. Why, then, would the personal private securities transactions under the Proposal be any less important for the employer member to be aware of, approve, and monitor? Especially in light of the fact that an account at another regulated entity is at least subject to the supervision of that entity, as well as subject to FINRA and SEC rules, while personal private securities transactions may take place through unknown and unregulated entities.

My final comment involves an area that, frankly, I had not focused on in Rule 3040 and 3280, and came to my attention as a result of an expert witness engagement I was retained for. Currently, Rule 3280, in defining the term "private securities transactions", excludes "…..transactions ***among*** immediate family members (as defined in FINRA Rule 5130), for which no associated person receives selling compensation…" (emphasis added). The Proposal, in Supplementary Material .01 (a) modifies this language to exclude "transactions ***on behalf of*** the registered person's immediate family members (as defined in FINRA Rule 5130 for which the registered person receives no transaction-related compensation;" (emphasis added). While the change may seem insignificant, based on my experience it is not.

The word "among" used in the definition in Rule 3280 is widely understood to be interchangeable with the word "between". In my experience, what FINRA means when it excludes transactions between immediate family members is exactly that, for example, Brother A owns securities which he sells to Brother B. One need only review NASD Notice to Members 85-21 entitled "Request for Comments on Proposed Rule on Private Securities Transactions" seeking comments from NASD member and other interested parties to the then new proposed selling away rule to see the thinking and intent of the NASD Board of Governors as it related to transactions among immediate family members which I believe confirms my opinion. The Notice states in its relevant part "The Board believes that there may be some transactions in which associated persons participate without compensation which should not be subjected to the same level of scrutiny as other transactions. For example, a salesperson may own stock in a closely held family corporation and wish to transfer that stock to another family member. While his or her firm should be made aware of such a transaction, it appears unnecessary to treat that type of transaction as a transaction of the employer firm." If it was the NASD Board's intention to exclude all transactions ***involving*** immediate family members, such more expansive language would have been used. It was never the intention to exclude all such persons from the protections of the rule.

However, the language change that is contained in Supplementary Material .01 of the Proposal using the term "on behalf of" <u>would</u> exclude immediate family members from the protections of the new rule. Importantly, adding to this concern is the reference in Rule 3040 and in the Proposal defining the term "immediate family member" by citing the definition of the term in Rule 5130 (formerly 2790). Rule 5130, entitled "Restrictions on the Purchase and Sale of Initial Public Offerings", defines immediate family member very broadly, as follows: ""Immediate family member" means a person's parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person provides material support." Of particular note in this definition in Rule 5130 is that it even encompasses <u>non-family members</u> by including "….any

individual to whom the [associated] person provides material support." Material support is not defined. The definition is expansive as it is trying to cast the widest net of persons who are subject to IPO restrictions under Rule 5130.

In my opinion, it is not in the interest of investor protection to exclude such a wide swath of individuals from the protections provided by Rule 3040 and the Proposal, when in fact these rules are enacted to protect such persons from the dangers brought about when associated persons are engaged in selling away activities. These include, for example, the financial exploitation of senior citizens and other protected categories of individuals who are susceptible to financial exploitation. These would include not only relatives of the registered person, but also non-family members to whom the representative is providing material support. Clearly, this is not what the selling away rule was designed to accomplish. Use of an expansive definition designed to cast a wide net for IPO restrictions is the opposite of the more restrictive definition I believe should be used in a rule like the Proposal, especially when it is being used to exclude from the rule securities transactions being executed outside the scope of the person's employer broker-dealer.

Thank you for the opportunity to provide my comments. Should you have any questions, or wish to discuss any aspects of this letter, please feel free to contact me at 301-983-1716, or johnepinto@aol.com.

Very truly yours,

John E. Pinto