

April 26, 2018

By email to pubcom@finra.org

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

Re: FINRA Regulatory Notice 18-08
Outside Business Activities of Registered Persons
& Private Securities Transactions of Associated Persons

Dear Ms. Mitchell:

On behalf of the Investor Protection Clinic at the William S. Boyd School of Law at the University of Nevada, Las Vegas (“Clinic”), I write to comment on FINRA Regulatory Notice 18-08. The Clinic provides pro-bono assistance to investors who have suffered losses but cannot otherwise obtain representation because of the size of their claims. Our clients have a direct interest in the rules promulgated by the Financial Industry Regulatory Authority (“FINRA”).

We thank you for the chance to comment on proposed changes to FINRA’s rules governing the outside business activities (“OBAs”) and the private securities transactions (“PSTs”) of members, registered persons, and unregistered associated persons (“unregistered representatives”).

Member supervision of registered persons and unregistered representatives is essential to investor protection. Reduced supervision for unregistered representatives and non-investment related OBAs may increase fraud. As discussed in more detail below, the Clinic believes that FINRA should alter the proposed rule to address these investor protection concerns.

Request for Comment No. 3. *Unlike Rule 3280, the proposed rule would apply to registered persons, rather than to associated persons. Should the proposed rule be expanded to apply to all associated persons? If so, why?*

FINRA Rule 3280 now requires persons “associated with a member” to comply with FINRA’s rule for PSTs.¹ The proposed rule would reduce oversight and require only registered persons to report OBAs and PSTs, excluding unregistered representatives from reporting obligations. In support, Regulatory Notice 18-08 justifies excluding unregistered representatives “because *the risk of potential conflicts is more prevalent with regard to registered persons.*”² That registered persons pose a greater risk than unregistered representatives does not mean that unregistered representatives should escape supervision.

¹ FINRA Rule 3280(a).

² FINRA, Regulatory Notice 18-08: Outside Business Activities at 4 (Feb. 26, 2018) (emphasis added).

Unregistered representatives also present meaningful risks to investors. Exempting them from reporting both their OBAs and PSTs to their member firms will likely increase “selling away” frauds. FINRA’s guidance authorizes unregistered representatives to interact with investors directly for: (1) extending invitations to firm-sponsored events; (2) inquiring whether potential clients wish to discuss investments with a registered member; and (3) inquiring whether potential clients wish to receive investment literature.³ Although FINRA rules limit their actual authority, investors interacting with unregistered representatives likely fail to appreciate fine distinctions between a member firm’s representatives.

Reducing supervision now appears problematic because, as FINRA knows, fraudsters have become more strategic and sophisticated about evading supervision. Thomas Drogan, FINRA Senior Vice President and Deputy, Member Regulation’s Office of Sales Practice, recently spoke before the Securities and Exchange Commission’s Investor Advisory Committee. Mr. Drogan expressed concern about seeing “more sophisticated means for registered reps within the broker dealer space to get investors to invest in private securities. . .”⁴ He explained that fraudsters were evading supervision by causing customers to move funds in ways that frustrate a member’s oversight. In particular, he detailed how associated persons were “encouraging their customers . . . to send money from their brokerage account to their bank account” before transferring funds to the associated person’s outside business activity.⁵ Reducing oversight and excluding unregistered representatives from reporting obligations and member supervision may provide a road-map for how to use unregistered representatives to conduct fraud.

The Clinic recommends that FINRA alter the proposed rule to preserve supervision for all associated persons.

Request for Comment No. 5. *A member’s obligation to conduct a risk assessment is only triggered under the proposal with respect to investment-related activities.*

- a. *Does limiting the required risk assessment to activities that are “investment-related” properly balance the interest of allowing members to focus on compliance efforts on activities that pose the greatest concerns and any potential harm to investors?*

The proposed rule requires registered persons to notify members when involved in both investment-related *and* “other business activity.” The proposal only requires members to assess investment-related activities.

FINRA must extend these assessment obligations to all “other business activities” to protect investors from fraud. Associated persons that participate in “selling away” fraud schemes may use their non-investment related “business activities.” For example, a registered broker who owns a private, local business would be obligated to report the activity under the proposal, but the member would be under no obligation to assess this activity. Absent an assessment obligation, member firms will probably forgo assessing these activities, thereby increasing the likelihood for investor

³ FINRA Notice to Members 00-50 (Aug. 2000).

⁴ Thomas Drogan, Investor Advisory Committee Meeting, SEC, at 45:38 (Mar. 8, 2018), *available at* https://www.sec.gov/video/webcast-archive-player.shtml?document_id=030818iac.

⁵*Id.*

fraud. All that it would take to convert a non-investment related OBA into an investment-related OBA is a single fraudulent pitch. Shifting member oversight away from non-investment related OBAs may cause fraudsters to shift their schemes to exploit reduced oversight.

Respectfully Submitted,

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/s/ Jacob D. Crawley

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