

FINRA Proposes to Ease Regulation of Outside Business Activities

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FINRA has proposed a major paradigm shift for regulating outside business activities (OBAs) and private securities transactions (PSTs) of broker-dealer personnel. Under FINRA's proposal, a single new rule (Rule 3290) would replace current Rules 3270 (OBAs) and 3280 (PSTs) and would require registered persons to provide their member firms with prior written notice for all investment-related or other business activities outside the scope of their relationship with the member.

Work for Affiliates Excluded

Importantly for insurance-affiliated broker-dealers, work performed on behalf of a FINRA member firm's affiliates, such as an affiliated insurance company or agency, would be excluded from the rule, unless it is "broker-dealer" activity: *i.e.*, activity that would, but for the registered person's association with the member firm, require registration as a broker-dealer. (See Insurance Activity Examples, below.)

Non-broker-dealer work performed on behalf of an affiliated investment adviser (IA), affiliated bank, or relating to a registered person's personal investments, also would be excluded.

Approval of Investment-Related Activities

With respect to investment-related activities (but not other OBAs), a registered person would be required to receive prior written approval from the member before participating in the activity. The definition of "investment-related" is the same as that currently used in Form U4: "pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, issuer, investment company, investment adviser, futures sponsor, bank, or savings association)."

Upon receiving notice of an investment-related activity, the member firm would be obligated to perform a reasonable risk assessment of the activity and determine whether to approve, approve with conditions or limitations, or disapprove the registered person's participation in the activity. Non-investment-related activities no longer would require a member firm to conduct a risk assessment.

Supervision

The new rule would require supervision by member firms in two situations. First, if the activity is approved subject to conditions or limitations, the firm would have to supervise compliance therewith.

Second, supervision is required for broker-dealer activity. FINRA explained: "if the person can only legally engage in the . . . activity because the person is associated with a member, the member approving that activity must treat it as its own."

PSTs

The term "private securities transaction" is not part of the proposed rule. However, OBAs that involve selling securities away from the broker-dealer would be subject to the same analysis and requirements as other investment-related activities. This means that, unlike current Rule 3280, proposed Rule 3290 would not apply to PSTs (as currently understood) of a member firm's associated person that is not also a registered person of the firm.

Insurance Activity Examples

By way of example, although the term "investment-related" would be defined to mean, among other things, "pertaining to . . . insurance," a registered person's activity on behalf of an affiliated life insurance company or agency would be excluded from the rule unless that activity is broker-dealer activity. Therefore:

- A registered person whose member firm is not affiliated with an insurance company or agency would be required to provide notice to, and obtain approval from, his/her member firm prior to engaging in insurance activity on behalf of that company/agency.
- A registered person whose member firm is affiliated with the insurance company/agency would not be required to give notice or obtain approval of such insurance activity unless it constitutes broker-dealer activity.

- In both cases, a member firm would be required to (a) supervise and maintain records concerning any such insurance activity that constitutes broker-dealer activity, (b) supervise compliance with any limitations or conditions that the firm imposes on any approval of any of its registered persons' insurance activities, and (c) maintain other records demonstrating compliance with the new rule.

FINRA received approximately 52 comment letters on the proposal, most favoring the new rule, some suggesting clarifications, and a small number questioning the rule's exclusion of PSTs of associated persons that are not registered persons. After evaluating the comments and making any changes, FINRA would send the proposed rule to the SEC for consideration and approval following a notice and comment period.

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