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"REASONABLE" DOES NOT MEAN PERFECT: RECENT FINRA REGULATORY DEVELOPMENTS AND INTERPRETIVE QUESTIONS

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"[A] broker-dealer would be required to meet a care obligation that the recommendation is in the best interest of the retail customer. Specifically, a broker-dealer would need to exercise reasonable diligence, care, skill and prudence in making the recommendation. ***That concept of reasonableness which is found throughout the rule is an important one. Reasonable does not mean perfect advice—a standard that no one can meet.*** *The recommendation also must be in the best interest of the retail customer at the time it is made, rather than being evaluated in hindsight. In other words, the proposal recognizes that there may be circumstances where a broker-dealer's advice does not work out in hindsight, even though it was reasonable at the time when it was given."*

Remarks of Brett Redfearn, Director, Division of Trading and Markets, Securities and Exchange Commission, at the FINRA Annual Conference (May 22, 2018).

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I. INTRODUCTION AND OVERVIEW

"Reasonable" – variants of the term are liberally interspersed throughout the rules and guidance of the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA). To document regulators' reliance on a "reasonableness" standard, I prepared Appendix A to this outline, which captures the extent to which variants of the term are used in SEC releases, FINRA Regulatory Notices, and SEC and FINRA interpretive guidance.

Lawyers will remember their first exposure to the concept of the "reasonable man" in law school. Victorian English jurists developed the concept of an ordinary man who rode a particular bus route in London (the Clapham omnibus) to exemplify a reasonably educated, intelligent but nondescript person, against whom other's conduct could be measured. Thus, in *Blyth v. Birmingham Water Works,* [2] plaintiff's property was flooded during exceptionally cold weather by the failure of a valve in the defendant's water pipes. Baron Alderson ruled that the defendant was not required to take every possible precaution to prevent flooding from bursting pipes, but to do only as much as "a reasonable man . . . would do."

Fast forward to the 21st century, where courts now try to resolve an issue by asking how a "reasonable person" would behave in a particular situation. Regulators are no different. No matter the topic, regulators can be expected to rely on a reasonableness standard. Sometimes, the standard is restated or repackaged without actually referencing "reasonable." For example, FINRA's rules governing communications with the public require "fair and balanced," just another way of saying reasonable. But make no mistake, today's regulatory standard is not significantly different from that established by Baron Alderson more than 150 years ago. That said, the SEC's former Director of the Division of Trading and Markets summed it up this way: reasonable does mean perfect, because perfect is a standard no one can meet.

This outline is comprised of two parts: 1) an overview of recent FINRA regulatory developments – primarily from late 2019 through the end of September 2021 – affecting the distribution of insurance products (Sections II – VII), and 2) select FINRA communications with the public and electronic media developments for the same period (Section VIII). The first part discusses FINRA regulatory developments where the reasonableness standard of care is explicitly stated, while the second part discusses advertising and social media developments where reasonableness is implied.

For context, Appendix A also includes some early uses and some non-SEC, non-FINRA uses of these terms. Of course, this is not an exhaustive list. Further, the list raises, but does not answer, questions such as: what does it mean to have a reasonable basis to believe, to consider reasonable alternatives, to exercise reasonable diligence, care and skill, to take reasonable steps, *etc.*?

[2] *Blyth v. Birmingham Water Works*, 156 Eng. Rep. 1047 (Ex. 1856).

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II. REGULATION BEST INTEREST AND CHANGES TO FINRA RULES

A. Background

1. The SEC adopted Regulation Best Interest on June 5, 2019.[3] Thereafter, one would reasonably expect that FINRA would amend its general suitability rule 2111, its non-cash compensation rules, and its capital acquisition broker rule to "provide clarity on which standard applies,"[4] which is exactly what FINRA did. But, as discussed below, FINRA did not amend Rule 2330 (variable annuity suitability).

2. **Suitability**

   a. FINRA amended Rule 2111 (Suitability) to:

      - state that it will not apply to recommendations subject to Regulation Best Interest; and

      - remove the element of control from the quantitative suitability obligation, consistent with Regulation Best Interest.

   b. FINRA did not amend Rule 2330 (variable annuity suitability). Instead, it explained that both Regulation Best Interest and Rule 2330 apply to recommendations of variable annuities, as follows: "To the extent that a broker-dealer or associated person is recommending a purchase or exchange of a deferred variable annuity to a retail customer, Reg BI's obligations, discussed above, also would apply."[5]

3. **Non-Cash Compensation**

   a. Regulation Best Interest "requires broker-dealers to establish, maintain, and enforce written policies and ***procedures reasonably***

[3] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Exchange Act Release No. 86031 (June 5, 2019), *available at* https://www.sec.gov/rules/final/2019/34-86031.pdf [Hereinafter, Regulation Best Interest Adopting Release].

[4] *FINRA Amends Its Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest*, FINRA Regulatory Notice 20-18 (June 19, 2020), *available at*https://www.finra.org/sites/default/files/2020-06/Regulatory-Notice-20-18.pdf.

[5] 2021 Report on FINRA's Examination and Risk Monitoring Program (Feb. 2021) at p. 26, *available at* https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf.

designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited time period."[6]

b. FINRA amended its non-cash compensation rules to provide that the practices addressed by those rules also must be consistent with Regulation Best Interest. "The purpose of these amendments is to ensure that these rules' limits on non-cash compensation are read consistently with the SEC staff's interpretations of [Regulation Best Interest], including in particular paragraph (a)(2)(iii)(D)."[7]

B. Collection of Retail Customer Information

1. Regulation Best Interest Standard

In adopting Regulation Best Interest, the SEC stated: "Broker-dealers must obtain and analyze ***enough customer information*** to have a ***reasonable basis to believe*** that the recommendation is in the best interest of the particular retail customer. The significance of specific types of customer information generally will depend on the facts and circumstances of the particular case, including the nature and characteristics of the product or strategy at issue."[8]

2. FINRA Rule 2330 Standard

FINRA Rule 2330 (variable annuity suitability) also requires collection of customer information prior to making a recommendation. In some instances, Rule 2330 information is different from Regulation Best Interest. Since both rules apply, broker-dealers must collect the universe of required information.

3. Exchange Act Account Record Rule

In addition, Rule 17a-3(a)(17)(i)(A) under the Securities Exchange Act of 1934 (Exchange Act) (account record rule) requires collection of customer information. In most cases, account record information is different from both Regulation Best Interest and Rule 2330 information.

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[6] *Id.*

[7] *Id*. at n. 7.

[8] Regulation Best Interest Adopting Release, *supra* note 3, at p. 276 (emphasis added).

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4. **Illustration of Customer Information**

The below table illustrates information required to be collected from retail customers who purchase a variable annuity:

	Information to be Collected from Retail Customers Prior to Recommendation	**Regulation Best Interest (Retail Customer Investment Profile)**	**FINRA Rule 2330 (Variable Annuity Suitability)**	**Exchange Act Rule 17a-3(a)(17)(i)(A) (Customer Account Record)[9]**
1	Customer's age	✓	✓	✓ (DOB)
2	Other investments	✓		
3	Financial situation and needs	✓	✓	
4	Tax status	✓	✓	
5	Investment objectives	✓	✓	✓
6	Investment experience	✓	✓	
7	Investment time horizon	✓	✓	
8	Liquidity needs	✓	✓	
9	Risk tolerance	✓	✓	
10	Any other information *the retail customer may disclose* to the broker-dealer or associated person in connection with the recommendation	✓		
11	Annual income		✓	✓
12	Intended use of the deferred variable annuity		✓	
13	Existing assets (including investment and life insurance holdings)		✓	
14	Liquid net worth		✓ (liquid net worth)	✓ (net worth excluding value

[9] Unlike Regulation Best Interest and FINRA Rule 2330, Exchange Act Rule 17a-3(a)(17) does not require broker-dealers subject to the account record rule to obtain account record information prior to a recommendation. Also, in the case of a joint account, the account record must include personal information for each joint owner who is a natural person; however, financial information for the individual joint owners may be combined. The account record must indicate whether it has been signed by the associated person responsible for the account, if any, and approved or accepted by a principal of the broker-dealer.

	Information to be Collected from Retail Customers Prior to Recommendation	Regulation Best Interest (Retail Customer Investment Profile)	FINRA Rule 2330 (Variable Annuity Suitability)	Exchange Act Rule 17a-3(a)(17)(i)(A) (Customer Account Record)[9]
				of primary residence)
15	Such other ***information used or considered to be reasonable by*** the member or associated person in making the recommendation		✓	
16	Customer's or owner's name			✓
17	Tax identification number			✓
18	Address			✓
19	Telephone number			✓
20	Employment status (including occupation and whether customer is an associated person of a broker-dealer)			✓

5. SEC Adopting Release

In adopting Regulation Best Interest, the SEC cited to FINRA 2330 when it addressed the factors to consider when making a recommendation of a variable annuity as follows: "For example, prior to recommending a variable annuity to a particular retail customer, broker-dealers should generally develop ***a reasonable basis to believe*** that the retail customer will benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit."[10]

6. Information to Collect and Analyze

Thus, when collecting a customer's investment profile information, an associated person recommending a variable annuity to a retail customer may not rely on Regulation Best Interest alone or on FINRA Rule 2330 alone because both apply. The associated person should collect all items listed above – required by Regulation Best Interest and Rule 2330 – prior to making

[10] Regulation Best Interest Adopting Release, *supra* note 3, at p. 271.

a recommendation. And if the account record rule applies, collect that information as well.

III. RULE REQUIRING REGISTERED PERSONS TO DECLINE DESIGNATION AS A BENEFICIARY, EXECUTOR, AND/OR TRUSTEE OF A CLIENT'S ESTATE OR HOLDING A POWER OF ATTORNEY ON BEHALF OF A CLIENT

A. FINRA Rule 3241[11]

1. Approval and Effective Dates

In light of numerous FINRA enforcement actions involving registered persons who were designated as beneficiary of a client's account and/or estate, it is reasonable to expect that FINRA would adopt a rule to help curtail this behavior. The SEC approved adoption of FINRA Rule 3241 on October 7, 2020. Rule 3241 became effective on February 15, 2021.

2. Text of Rule

FINRA Rule 3241 states that a registered person shall ***decline***:

- "***being named a beneficiary of a customer's estate*** or receiving a bequest from a customer's estate upon learning of such status unless one of the following conditions is satisfied:

  (A) The customer is a member of the registered person's immediate family; or

  (B) Upon learning of such status, the registered person provides written notice describing the proposed status to the member with which the registered person is associated, in such form as specified by the member, and receives written approval from that member of such status prior to being named a beneficiary of a customer's estate or receiving a bequest from a customer's estate. If the member disapproves the status or places conditions or limitations on it, the registered person shall not assume such status or shall comply with such conditions or limitations."

[11] *Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change To Adopt FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer),* Exchange Act Release No. 90116 (Oct. 7, 2020) (emphasis added), *available at* https://www.sec.gov/rules/sro/finra/2020/34-90116.pdf.

- "***being named as an executor or trustee or holding a power of attorney*** or similar position for or on behalf of a customer upon learning of such status unless one of the following conditions is satisfied:

  (A) The customer is a member of the registered person's immediate family; or

  (B) Upon learning of such status, the registered person provides written notice describing the position and the person's proposed role to the member with which the registered person is associated, in such form as specified by the member, and receives written approval from that member of such status prior to acting in such capacity or receiving any fees, assets or other benefit in relation to acting in such capacity; and

    (i) The registered person does not derive financial gain from acting in such capacity other than from fees or other charges ***that are reasonable and customary for acting in such capacity***; and

    (ii) If the member disapproves the position or places conditions or limitations on it, the registered person shall not act in such capacity or shall comply with such conditions or limitations."

B. FINRA Rule 3241 Effective Date Considerations

1. Treatment of Pre-Existing Designations

The SEC release adopting Rule 3241 addresses the timing of effectiveness of the Rule and concludes that the Rule applies ***after the effective date*** but does not apply to pre-existing beneficiary designations, as follows:

> ***"The proposed rule would apply if the registered representative is named a beneficiary or receives a bequest from a customer's estate <u>after</u> the effective date of the proposed new rule***. For the non-beneficiary positions, the proposed rule would apply to positions that the registered representative was named to prior to the rule becoming effective only if the initiation of the customer relationship between the registered representative and the customer occurred after the effective date of the proposed rule."[12]

[12] *Id.* at p. 6 (footnotes omitted) (emphasis added).

2. Rationale for Prospective Application

The Commission explained the rationale for applying the rule prospectively as follows:

> "A commenter also asked FINRA to apply the proposed rule to ***preexisting beneficiary designations*** or designated positions of trust. In particular, the commenter believes that more investors should benefit from the proposed rule's protections. In response, FINRA stated that many of its member broker-dealers already have policies and procedures prohibiting or imposing limitations on being named as a beneficiary or to a position of trust when there is not a familial relationship. Accordingly, many preexisting beneficiary designations or positions of trust have already been addressed by their respective firms. ***Moreover, FINRA believes that it would be challenging and time-consuming for broker-dealers to conduct a full-scale retroactive review of all accounts across an organization to determine whether the arrangements currently in place are consistent with the proposed requirements***. In addition, customers may have relied on a broker-dealer's approval of arrangements currently in place in drafting estate or other legal documents, handling their assets or performing some duties (*e.g.*, a registered representative may have been named a customer's trustee in reliance on the firm's prior approval). As such, FINRA states that retroactively applying the obligations of the proposed rule would further compound the challenge for broker-dealers, registered representatives and customers.
>
> The Commission acknowledges that if applied retroactively the proposed rule's protections could benefit more customers who designated their registered representative a beneficiary or to hold a position of trust. However, the Commission also acknowledges the resources (financial and time) firms would expend to retroactively apply the proposed rule to existing customers, as well as the potential disruption to customers who have relied on existing arrangements with their registered representatives. ***Accordingly, the Commission believes that it is appropriate only to apply the rule prospectively***. To the extent a registered representative was named by a customer as a beneficiary or to a position of trust prior to the effective date of the proposed rule, if that registered representative takes a job with, and moves the customer's account to, a new broker-dealer following the effective date, she and her new firm would be subject to the proposed rule's obligations."[13]

[13] *Id.* at pp. 11-12 (footnotes omitted) (emphasis added).

C. FINRA Rule 2010 – Just and Equitable Principles of Trade

1. Violation of Firm Policy

FINRA Rule 2010 requires associated persons to observe "high standards of commercial honor and just and equitable principles of trade." As discussed below, FINRA takes the view that "[a]n associated person violates FINRA Rule 2010 when he or she accepts fiduciary or beneficiary designations from customers contrary to the policies his or her firm."[14] FINRA has further explained that:

> "FINRA Rule 2010 encompasses all unethical, business-related conduct, even if that conduct does not involve a security or a securities transaction. Conduct that reflects negatively on an associated person's ability to comply with regulatory requirements fundamental to the securities industry is inconsistent with just and equitable principles of trade. ***A violation of an employer firm's policies can violate just and equitable principles of trade***."[15]

D. FINRA Enforcement Precedent

Prior to adoption and effectiveness of Rule 4231, FINRA took enforcement action in a number of cases involving registered representatives named as beneficiary to a client's account and/or estate. Below is a table showing disciplinary sanctions imposed by FINRA, followed by a brief summary of the FINRA enforcement matters, beginning with the most recent action in September 2021.

	Case Name	**Date of FINRA AWC or Decision**	**FINRA Disciplinary Sanction**
1	Jerry Rice	Sept. 17, 2021	six-month suspension from associating with any FINRA member in all capacities; and a $10,000 fine
2	Clyde Anthony Jensen	Aug. 27, 2021	six-month bar from associating with a FINRA member and $10,000 fine
3	Jeffrey Warren	May 28, 2021	bar from associating with FINRA member in any capacity

[14] *See Robert Charles Torcivia*, FINRA Letter of Acceptance, Waiver and Consent (AWC), *infra* note 28.

[15] *See Julian Jay Piekarczyk, infra* notes 25 & 26 (footnotes omitted); *see also Clyde Anthony Jensen, infra* note 17 (emphasis added).

	Case Name	Date of FINRA AWC or Decision	FINRA Disciplinary Sanction
			(for refusing to respond to FINRA 8210 request)
4	Gary Len Wells	April 29, 2021	15-month suspension from associating with any FINRA member in all capacities; and a $20,000 fine
5	Jimmie Darrell Summers	April 19, 2021	45-calendar-day suspension from associating with any FINRA member in all capacities; and a $5,000 fine
6	Jenny Xinfang Feng	Feb. 12, 2021	six-month suspension from associating with any FINRA member in any capacity and a $7,500 fine
7	Wenru Liang	Feb. 12, 2021	six-month suspension from associating with any FINRA member in any capacity and a $7,500 fine
8	Beth L. Klein Friedman	Dec. 22, 2020	three-month suspension from associating with any FINRA member in any capacity and a $5,000 fine
9	David Jin Kyu Chong	Dec. 20, 2020	11-month suspension from associating with any FINRA member in any capacity; and a $20,000 fine
10	Julian Jay Piekarczyk	Sept. 25, 2020	bar from associating with a FINRA member in any capacity (default decision)
11	Steven Jun Lu	April 7, 2020	bar from associating with a FINRA member in any capacity
12	Robert Charles Torcivia	Sept. 26, 2018	seven-month suspension and $10,000 fine
13	Steven Anthony Olejniczak	May 8, 2017	six-month suspension and $10,000 fine
14	Wonnie Lynn Short	May 2, 2016	bar from associating with a FINRA member in any capacity
15	Charles Eugene Bishop, Jr.	Sept. 10, 2012	two-year suspension and $7500 fine
16	Richard Shu	May 9, 2012	eight-month suspension and $50,000 fine
17	Marylan Taylor	Feb. 7, 2007	NAC reversed hearing panel finding and dismissed allegation that registered representative substituted her name (instead of daughter of client) on client's

	Case Name	Date of FINRA AWC or Decision	FINRA Disciplinary Sanction
			annuity beneficiary designation form. For other violations (false letter and false testimony), bar in all capacities and costs

1. **Jerry Rice** (Sept. 17, 2021). The AWC alleges that, in circumvention of the firm's written supervisory procedures, Rice accepted monetary gifts in the amount of $477,000 from a 89-year old widow customer and was named as a beneficiary in the same customer's will. Rice also did not disclose the gifts and bequest in his annual compliance questionnaire. Without admitting or denying the findings, Rice consented to a six-month suspension from associating with any FINRA member in all capacities and a $10,000 fine.[16]

2. **Clyde Anthony Jensen** (Complaint, Feb. 26, 2021; Order Accepting Offer of Settlement, Aug. 27, 2021). Jensen, a former registered representative, requested permission from his member firm to be named as a beneficiary of nine securities (approximately $662,000) in one of a client's accounts. Jensen's supervisor denied the request and told Jensen that firm policy prohibited either him or his family members from being a named a beneficiary of the client's accounts. Without approval and in violation of Rule 2010, Jensen became the primary beneficiary, and his children became contingent beneficiaries, of the client's nine securities. Jensen failed to disclose to his supervising registered principal at the firm that he had been named beneficiary of the customer's trust. Also in violation of Rule 2010, Jensen submitted a false annual compliance attestation to his member firm respecting his beneficiary status. Without admitting or denying the allegations of the complaint, as amended by a settlement offer, Jensen consented to a six-month suspension and a $10,000 fine.[17]

3. **Jeffrey Warren** (May 28, 2021). The matter arose out of a complaint from a beneficiary of a deceased Oppenheimer customer regarding a gift the customer provided to Warren, a former Oppenheimer representative, prior to the customer's death. FINRA sent an information request pursuant to Rule 8210 to Warren and

[16] FINRA AWC (Case No. 2019064312901), *available at* https://www.finra.org/sites/default/files/fda_documents/2019064312901%20Jerry%20Rice%20CRD%20375290%20AWC%20%20jlg.pdf.

[17] FINRA OHO Order Accepting Offer of Settlement (Disciplinary Proceeding No. 2018059733101) (Aug. 27, 2021), *available at* https://www.finra.org/sites/default/files/fda_documents/2018059733101%20Clyde%20Anthony%20Jensen%20CRD%205658476%20Order%20Accepting%20Offer%20rjr%20%282021-1632961213093%29.pdf. *See also* FINRA Department of Enforcement Complain*t*, filed Feb. 26, 2021, *available at* https://www.finra.org/sites/default/files/fda_documents/2018059733101%20Clyde%20Anthony%20Jensen%20CRD%205658476%20Complaint%20jlg%20%282021-1617841202238%29.pdf.

Warren, through counsel, refused to respond. Without admitting or denying the findings, Warren consented to a bar of associating with a FINRA member in any capacity.[18]

4. **Gary Len Wells** (April 29, 2021). The matter originated from a review conducted in connection with information received by FINRA's Senior Helpline. A customer designated Wells as a beneficiary and fiduciary in her will. Following the customer's death at age 92, Wells received bequests of over $600,000 from the client's estate in contravention of firm's written supervisory procedures and provided false answers on his annual compliance questionnaire. Wells violated FINRA Rule 2010. Without admitting or denying the findings, Wells consented to a 15-month suspension from associating with any FINRA member in all capacities and a $20,000 fine.[19]

5. **Jimmie Darrell Summers** (April 19, 2021). The AWC alleges that Summers circumvented his member firm's "procedures that prohibited registered representatives from being named as a trustee, successor trustee, or executor for a firm customer, or from having power of attorney for a firm customer, except when the customer was a member of the representative's immediate family." Summers was named the successor trustee for a firm customer's living trust; was named the personal representative of the customer's estate in the customer's will; and was appointed power of attorney and medical power of attorney for the customer, who was not a member of Summers' family. In another instance, Summers was named the sole beneficiary of an annuity held by the customer. As a result, Summers violated FINRA Rule 2010. Without admitting or denying the findings, Summers consented to a 45-calendar-day suspension from associating with any FINRA member in all capacities and a $5,000 fine.[20]

6. **Jenny Xinfang Feng** (Feb. 12, 2021). The AWC alleges that Feng "circumvented her firm's policies and procedures by assisting an elderly customer to designate her and a colleague as beneficiaries on the customer's variable annuity policy, misrepresenting their relationship with the customer to the annuity company, and attempting to conceal her conduct from her firm, thereby violating FINRA Rule 2010." Feng assisted a vulnerable 87-year old widow living in an

[18] FINRA AWC (Case No. 2021070775901), *available at* https://www.finra.org/sites/default/files/fda_documents/2021070775901%20Jeffrey%20Warren%20CRD%202707969%20AWC%20va%20%282021-1624839616984%29.pdf.

[19] FINRA AWC (Case No.2019064851901), *available at* https://www.finra.org/sites/default/files/fda_documents/2019064851901%20Gary%20Len%20Wells%20CRD%201142058%20AWC%20va%20%282021-1622578817177%29.pdf.

[20] FINRA AWC (Case No. 2020065609101), *available at* https://www.finra.org/sites/default/files/fda_documents/2020065609101%20Jimmie%20Darrel%20Summers%20CRD%201467286%20AWC%20jlg%20%282021-1621470006538%29.pdf.

assisted living facility in changing beneficiaries on the widow's annuity to Feng. Without admitting or denying the findings, Feng consented to a six-month suspension from associating with any FINRA member in any capacity and a $7,500 fine.[21]

7. **Wenru Liang** (Feb. 12, 2021). The AWC alleges that Liang "circumvented her firm's policies and procedures by assisting an elderly customer to designate her and a colleague as beneficiaries on the customer's variable annuity policy, misrepresenting their relationship with the customer to the annuity company, and attempting to conceal her conduct from her firm, thereby violating FINRA Rule 2010." Liang assisted a vulnerable 87-year old widow living in an assisted living facility in changing beneficiaries on the widow's annuity to Liang. Without admitting or denying the findings, Liang consented to a six-month suspension from associating with any FINRA member in any capacity and a $7,500 fine.[22]

8. **Beth L. Klein Friedman** (Dec. 22, 2020). Friedman was named beneficiary and successor trustee of the estate of two elderly client's and did not disclose this to her firm. She violated firm procedures that prohibited registered representatives from being named as a beneficiary of the estate of any customer outside of the representative's immediate family and provided false answers on the firm's annual compliance questionnaire. She subsequently served as trustee and held a power of attorney for another client in violation of Rule 2010. Without admitting or denying the findings, Friedman consented to a three-month suspension from associating with any FINRA member in any capacity and a $5,000 fine.[23]

9. **David Jin Kyu Chong** (Dec. 20, 2020). Among other things, the AWC alleges that Chong did not disclose to his three FINRA member firm employers that he was a beneficiary of his firm customer's trust, appointed healthcare power of attorney for the same customer, and/or empowered to remove and/or appoint a successor trustee for the trust, in violation of NASD Rule 2110 and FINRA Rule 2010. Chong remained as beneficiary of his client's trust and made false statements on his firm's annual compliance questionnaire. Without admitting or

[21] FINRA AWC (Case No. 2018058750801), *available at* https://www.finra.org/sites/default/files/fda_documents/2018058750801%20Jenny%20Xinfang%20Feng%20CRD%206312900%20AWC%20sl%20%282021-1616113200944%29.pdf.

[22] FINRA AWC (Case No. 2018058750802), *available at* https://www.finra.org/sites/default/files/fda_documents/2018058750802%20Wenru%20Liang%20CRD%205157279%20AWC%20sl%20%282021-1616113198429%29.pdf.

[23] FINRA AWC (Case No. 2019063788401), *available at* https://www.finra.org/sites/default/files/fda_documents/2019063788401%20Beth%20L.%20Klein%20Friedman%20CRD%201432633%20AWC%20va%20%282021-1611274797099%29.pdf.

denying the findings, Chong consented to an 11-month suspension from associating with any FINRA member in any capacity and a $20,000 fine.[24]

10. **Julian Jay Piekarczyk** (June 16, 2020 Complaint; Sept. 25, 2020 Default Decision). In its compliant, FINRA Enforcement alleges that Piekarczyk "engaged in an unethical course of conduct by taking advantage of his relationship with a customer to benefit financially from the customer's policies and accounts. In doing so, Piekarczyk acted contrary to representations he made to his firm, Pruco Securities . . . and in circumvention of its policies designed to protect customers. . . . Specifically, in 2014, Piekarczyk notified Pruco that customer RB, who was 63 years old at the time, intended to name Piekarczyk as a beneficiary of RB's life insurance policy. Pruco's policies prohibited employees from being named as a beneficiary of a customer's policy or sharing in profits or losses realized in a customer's policy or account. Consistent with the Firm's policies, Pruco informed Piekarczyk that he could not be named a beneficiary of RB's policy without a Firm-approved exception. In response, Piekarczyk represented to Pruco that he would not be named a beneficiary of RB's policy."[25] Piekarczyk circumvented Pruco policies by having RB designate Piekarczyk's wife as a beneficiary on multiple financial products that Piekarczyk sold to RB and by assisting RB in making the beneficiary designations.

    Piekarczyk did not respond to FINRA's complaint. FINRA's Hearing Officer issued a default decision against Piekarczyk in which Piekarczyk was "barred from associating with any FINRA member in any capacity because, in violation of his employer firm's policies, [Piekarczyk] induced a customer to designate [Piekarczyk's] spouse as a beneficiary on financial products the customer purchased and induced the same customer to open a joint bank account with [Piekarczyk], granting him a right of survivorship. Piekarczyk failed to observe high standards of commercial honor and just and equitable principles of trade, in violation of FINRA Rule 2010."[26]

11. **Steven Jun Lu** (April 7, 2020). The AWC alleges that Lu accompanied an elderly customer showing signs of dementia to affiliate bank branches, allegedly attempting to open an affiliate bank account as a co-trustee and beneficiary on

[24] FINRA AWC (Case No. 2018059433001), *available at* https://www.finra.org/sites/default/files/fda_documents/2018059433001%20David%20Jin%20Kyu%20Chong%202679656%20AWC%20rrm%20%282021-1611361193305%29.pdf.

[25] FINRA OHO Complaint (Case No. 2018058117101) *available at* https://www.finra.org/sites/default/files/fda_documents/2018058117101%20Julian%20Jay%20Piekarczyk%20CRD%201128773%20Complaint%20va%20%282020-1594945168144%29.pdf.

[26] FINRA OHO Default Decision (Case No. 2018058117101), *available at* https://www.finra.org/sites/default/files/fda_documents/2018058117101%20Julian%20Jay%20Piekarczyk%20CRD%201128773%20OHO%20Decision%20jg%20%282020-1603930788995%29.pdf.

the account. Lu also entered into a power of attorney for the client's affairs, was appointed co-trustee over her assets, and was named as beneficiary of 75% of her estate. Lu violated the firm's written supervisory procedures and his actions violated Rule 2010. Without admitting or denying the findings, Lu consented to a bar from associating with any FINRA member in any capacity.[27]

12. **Robert Charles Torcivia** (Sept. 26, 2018). The AWC states that former Ameriprise registered representative "Torcivia improperly accepted fiduciary and beneficiary designations from three separate senior customers contrary to the policies of the firms with which he was associated at the time. Each of these three customers had a longstanding friendship with Torcivia. Specifically, Torcivia was a designated fiduciary on one health care [POA] for one customer, and two health care POAs for a second customer. Torcivia's wife was also designated as a beneficiary on the IRA account of the second customer, and Torcivia was designated as a beneficiary on a trust established by a third customer. Torcivia failed to inform his firm supervisors of these beneficiary listings, and did not request that the customers remove these beneficiary listings, as required by relevant firm policies. Ultimately, Torcivia's wife inherited approximately $133,000 from the second customer's IRA account, and Torcivia inherited approximately $30,000 from the third customer's trust. By virtue of the above, Torcivia violated NASD Rule 2110 and FINRA Rule 2010."

FINRA began investigating the matter after Ameriprise filed a U5 reporting Torcivia's termination for "failures to disclose fiduciary and beneficiary relationships with clients." Without admitting or denying the findings, Torcivia consented to a suspension from association with any FINRA member in any capacity for seven months and a $10,000 fine.[28] FINRA cites to the Torcivia matter in its Rule 3241 Regulatory Notices.

13. **Steven Anthony Olejniczak** (May 8, 2017). The AWC states that "Olejniczak [while associated with Edward D. Jones & Co.] violated FINRA Rule 2010 by failing to comply with the Firm's policies and procedures which: (1) required him to disclose that an elderly Firm customer had designated him and his wife as a beneficiary of the customer's Firm account, and that his wife had been named as a beneficiary of the customer's estate; (2) prohibited him from continuing to service the customer's Firm account while being named as a beneficiary of the account; and (3) required him to obtain the Firm's approval to be given medical power of

[27] FINRA AWC (Case No. 2018058642601), *available at* https://www.finra.org/sites/default/files/fda_documents/2018058642601%20Steven%20Jun%20Lu%20CRD%206856088%20AWC%20sl%20%282020-1588983571619%29.pdf.

[28] FINRA AWC (Case No. 2015044686701), *available at* https://www.finra.org/sites/default/files/fda_documents/2015044686701%20Robert%20Charles%20Torcivia%20CRD%20700880%20AWC%20sl%20%282019-1563455959961%29.pdf.

attorney over the customer." Edward Jones terminated Olejniczak. Without admitting or denying the findings, Olejniczak consented to a six-month suspension from association with any FINRA member in any capacity and a $10,000 fine.[29]

14. **Wonnie Lynn Short** (May 2, 2016). The AWC states, "While Short was registered with Wells Fargo, one of his clients, JW, executed a will naming Short executor of her estate and leaving two-fifths of her residuary estate to him. When JW passed away in November 2008, Short was appointed executor. One of the assets held by JW at the time of her death was an annuity worth approximately $102,000. Pursuant to a beneficiary designation form, 90% of the annuity was to go to a local charitable foundation, which was also a Wells Fargo customer, and 10% was to go to JW's estate. After Short submitted a claim form for the annuity, the annuity company sent JW's estate a check for the full amount of the proceeds from the annuity and all of the funds were deposited into the estate's account at Wells Fargo. The charitable foundation did not receive its portion of the annuity, approximately $92,000. As a result, when the residue of the estate was distributed, Short received more than $30,000 in additional funds to which he was not entitled. When the foundation later asked Short about the annuity, he falsely stated that JW had removed the foundation as a beneficiary. By failing to ensure that the foundation, a Wells Fargo customer, received the funds it was due from JW's annuity, and instead retaining the funds for JW's estate and, ultimately, his personal benefit, Short misused the funds in violation of NASD Rules 2330 and 2110 (for conduct occurring before December 15, 2008) and FINRA Rule 2010 (for conduct occurring on or after December 15, 2008)." Without admitting or denying the findings, Short consented to a sanction of a "bar from associating with any FINRA member in any capacity."[30]

15. **Charles Eugene Bishop, Jr.** (Sept. 10, 2012 Order; Dec. 5, 2011 Complaint). FINRA's Order Accepting Offer of Settlement notes, "During the period from January to June 2009, Bishop attempted to misappropriate approximately $3 million from an elderly customer of his employer, Merrill Lynch, in violation of FINRA Rule 2010. Bishop created paperwork by which the deceased customer's assets would be transferred to a purported entity [Dancing Bear Kennel] with a tax identification number assigned to him by the IRS as sole member. . . . Bishop attempted to misappropriate funds in violation of FINRA Rule 2010 thereby engaging in unethical conduct by failing 'to observe high standards of commercial

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[29] FINRA AWC (Case No. 2016050107901), *available at* https://www.finra.org/sites/defa.ult/files/fda_documents/2016050107901_FDA_JM992573%20%282019-1563225557308%29.pdf.

[30] FINRA AWC (Case No. 2011030221201), *available at* https://www.finra.org/sites/default/files/fda_documents/2011030221201_FDA_RB7X2680%20%282019-1563130169807%29.pdf.

honor and just and equitable principles of trade,' in that (i) Bishop had EL sign a Merrill Lynch TOD which designated as the sole beneficiary of EL's securities accounts DBKI, whose name was virtually identical to a company that EL owned, but whose tax identification number listed on the TOD was that of DBKI, a purported entity associated with Bishop as sole member; and (ii) the beneficiary's tax identification number on the Merrill Lynch CRA signed by customer EL was changed to the tax identification number for DBKI, a purported entity associated with Bishop as sole member." FINRA imposed a sanction of suspension from association with any FINRA member firm in all capacities for two years and a $7,500 fine.[31]

16. **Richard Shu** (May 9, 2012). The AWC states "Shu, a former registered representative with LPL, improperly accepted monetary gifts from a Firm customer and, without the Firm's knowledge and approval, engaged in outside business activities. As a result, Shu violated NASD Rules 3030 and 2110 and FINRA Rule 2010. Shu also violated NASD Rule 2110 and FINRA Rule 2010 by making a verbal misstatement and several written misstatements to the Firm relating to his acceptance of monetary gifts from a Firm customer and his undisclosed outside business activities. . . . Over time, the relationship transformed from traditional broker-customer to one in which the customers increasingly relied on Shu regarding their personal and business affairs. At all times relevant, the customers had no children, surviving siblings, parents or close family members. Beginning in 2007 and continuing to approximately May 2010, HY gifted to Shu and Shu's family members approximately $1 million in cash and securities and gave Shu approximately $300,000 for Shu's use in his outside business activities. Shu failed to disclose his receipt of the gifts to his firm or seek approval from his firm to receive the gifts."

    In addition, the AWC notes, "In 2008, Shu failed to disclose to LPL that he was the named beneficiary of HY's Individual Retirement Account at the Firm and on four of HY's annuity policies. The Firm's compliance policies relating to "Prohibited Activities," prohibited financial advisors from "[t]aking custody of securities, money or other property belonging to a customer." Question 17 of Shu's 2008 compliance questionnaire asked, "Do you have any knowledge of being a beneficiary in any non-family client trusts or wills (insurance policies, IRAs, etc.)?" Shu answered, "No" to this question, which was false. Shu knew that he was the beneficiary of HY's individual retirement account at LPL and was the beneficiary on four of HY's annuity policies." Without admitting or denying

[31] FINRA Order Accepting Offer of Settlement (Case No. 2009017699201), *available at* https://www.finra.org/sites/default/files/fda_documents/2009017699201_FDA_KMX23035%20%282019-1562793557391%29.pdf; FINRA OHO Complaint *available at* https://www.finra.org/sites/default/files/fda_documents/2009017699201_FDA_TP28365%20%282019-1562681963683%29.pdf.

the findings, Shu consented to a sanction of an eight-month suspension from association with any member of FINRA in any capacity and a $50,000 fine.[32]

17. **Marylan Taylor** (April 5, 2005 Complaint; Feb. 7, 2007 NAC Decision). NASD's Complaint states, "On or about February 25, 2003, public customer ES, an elderly widow, requested to change the beneficiary of an annuity policy to her daughter. Customer ES complied with Taylor's instructions to sign a blank beneficiary change request form. Outside the presence of customer ES, Taylor inserted her name and identifying information in the "Beneficiary Designation" section, and identified her relationship to customer ES as a "friend." Taylor also wrote that she was entitled to 100% of the proceeds of the annuity. Taylor made herself the beneficiary of customer ES' annuity without customer ES' consent or knowledge."[33]

    FINRA Enforcement began an investigation of Taylor's conduct in September 2003, following its receipt of the Form U5 submitted by Financial Network when it terminated Taylor's employment in August 2003. The matter spanned over several years and involved claims of forgery and false statements. With regard to the beneficiary designation form, the NAC determined on appeal, "We also find that the record does not support the Hearing Panel's conclusion that Taylor affixed her own name as the beneficiary of ES's annuity, instead of ES's daughter, without ES's knowledge and consent. The Hearing Panel's finding of violation on this allegation is not based on independent documentary evidence, but relies considerably on the testimony of Joe Randazzo. Yet the Hearing Panel did not make a specific finding that it found Joe Randazzo's testimony more credible on this issue than Taylor's. . . . Accordingly, we reverse the finding of the Hearing Panel and dismiss the allegation that Taylor substituted her own name for that of ES's daughter on a change of beneficiary form for one of ES's annuities."[34]

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[32] FINRA AWC (Case No. 2010023634601), *available at* https://www.finra.org/sites/default/files/fda_documents/2010023634601_FDA_AA5086%20%282019-1562743159546%29.pdf.

[33] NASD OHO Complaint (Case No. C8A050027), *available at* https://www.finra.org/sites/default/files/fda_documents/C8A050027_FDA_D457844%20%282019-1562309360557%29.pdf.

[34] NAC Decision (Case No. C8A050027), *available at* https://www.finra.org/sites/default/files/fda_documents/C8A050027_FDA_FX158117%20%282019-1561972755217%29.pdf.

IV. FINRA TAKES ADDITIONAL STEPS TO ADDRESS FINANCIAL EXPLOITATION OF SENIORS AND SPECIFIED ADULTS

A. FINRA Rule 2165 – Temporary Hold on *Disbursements*

1. Current Rule

FINRA Rule 2165 permits a firm to place a temporary hold on a disbursement of funds or securities from the account of a "specified adult" customer "when ***the firm reasonably believes that*** 'financial exploitation' of that adult has occurred, is occurring, has been attempted or will be attempted." In order to support firms' use of such holds to prevent potential financial exploitation, FINRA Rule 2165 provides firms and their associated persons with a safe harbor from certain other FINRA rules, as noted below.

2. Financial Exploitation Defined

Rule 2165(a)(4) defines "financial exploitation" (with emphasis added) as "(A) the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or (B) any act or omission by a person, ***including through the use of a power of attorney***, guardianship, or any other authority regarding a Specified Adult, to: (i) ***obtain control, through deception, intimidation or undue influence***, over the Specified Adult's money, assets or property; or (ii) convert the Specified Adult's money, assets or property."

3. Safe Harbor

FINRA Rule 2165 provides a safe harbor from FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts), and 11870 (Customer Account Transfer Contracts).

B. Proposed Amendments to FINRA Rule 2165 -- Temporary Hold on Disbursements *and Transactions* and Extending Temporary Hold

1. FINRA Proposes Hold on *Transactions*

a. Retrospective Review

"In August 2019, FINRA launched a retrospective review to assess the effectiveness and efficiency of its rules and administrative processes that help protect senior investors from financial exploitation. The review indicated that FINRA's steps to protect seniors have provided helpful and

effective tools in the fight against financial exploitation, but it also suggested some additional tools, guidance and rule changes."[35]

b. Proposed Uniform Standard

FINRA observed that some state laws and customer agreements permit placing holds on transactions. Accordingly, FINRA proposed amending Rule 2165 to create "the first uniform, national standard for placing holds on transactions related to suspected financial exploitation." In this regard, FINRA noted as follows, "FINRA recognizes that placing a temporary hold on a transaction is a serious step for a member and the affected customer. But FINRA also recognizes that placing a temporary hold on the underlying transaction may prevent significant negative financial consequences for the customer."[36]

2. FINRA Proposes Extending Temporary Hold Period

FINRA surveyed firms' experience with temporary holds on disbursements, noting that "of the member firms that indicated having placed a temporary hold, approximately 53 percent of survey respondents stated that the firm had been unable to resolve the matter within the 25-business day period provided by the rule. For firms responding that any matter took longer to resolve than the 25-business day period, approximately 35 percent indicated that it took on average 26 – 50 days to resolve the matter and approximately 59 percent indicated that it took on average 51 – 100 days to resolve the matter." Accordingly, FINRA proposed extending the temporary hold authorized by this Rule "for no longer than 30 business days following the date authorized by paragraph (b)(3) of this Rule, unless otherwise terminated or extended by a state regulator or agency of competent jurisdiction or a court of competent jurisdiction."[37]

3. FINRA Submits Proposal to SEC

The comment period for Regulatory Notice 20-34 ended on December 4, 2020. Following review of comments, FINRA filed with the SEC, on June 9,

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[35] *Senior Investors, Proposed Amendments to FINRA Rule 2165 and Retrospective Rule Review Report*, FINRA Regulatory Notice 20-34 (Oct. 5, 2020), *available at* https://www.finra.org/sites/default/files/2020-09/Regulatory-Notice-20-34.pdf.

[36] *Id.*

[37] *Id.*

2021, a proposal to amend FINRA Rule 2165.[38] The proposal would amend Rule 2165 to:

- permit member firms to place ***a temporary hold on a securities transaction***, subject to the same terms and restrictions applicable to a temporary hold on disbursements of funds or securities (disbursements), ***where there is a reasonable belief of financial exploitation*** of a "specified adult" as defined in the rule;

- permit member firms to ***extend a temporary hold, whether on a disbursement or a transaction, for an additional 30 business days*** if the member firm has reported the matter to a state regulator or agency or a court of competent jurisdiction; and

- require member firms to ***retain records of the reason and support for any extension of any temporary hold,*** including information regarding any communications with, or by, a state regulator or agency of competent jurisdiction or a court of competent jurisdiction.

4. SEC Solicits Comments

On September 22, 2021, the SEC published an order to solicit comments on the proposed rule change and to institute proceedings to determine whether to approve or disapprove the proposed rule change.[39] The comment period ended on October 13, 2021. As of the date of this outline, the SEC had not taken action to approve or disapprove FINRA's proposed changes to Rule 2165.

C. FINRA Rule 4512(a)(1)(F) – Trusted Contact Person

1. Current Rule

Effective February 5, 2018, FINRA Rule 4512 requires firms ***to make reasonable efforts to obtain*** the name of and contact information for a trusted contact person for a customer's account. The Rule applies upon the opening of a non-institutional customer's account or when updating account information

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[38] *See* Exchange Act Release No. 92225 (Jun. 22, 2021), 86 Fed. Reg. 34084 (Jun. 28, 2021) (File No. SR-FINRA-2021-016).

[39] *Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change to Amend Rule 2165 (Financial Exploitation of Specified Adults),* Exchange Act Release No. 93103 (Sept. 22, 2021), *available at* https://www.sec.gov/rules/sro/finra/2021/34-93103.pdf.

for a non-institutional account in existence prior to the effective date of the amendments.

2. Reasonable Efforts to Obtain

The Rule does not prohibit firms from opening and maintaining an account if a customer does not identify a trusted contact person as long as the member makes ***reasonable efforts to obtain*** the information. In this regard, FINRA notes as follows:

> "The trusted contact person is intended to be a resource for the member in administering the customer's account, protecting assets and responding to possible financial exploitation. A member may use its discretion in relying on any information provided by the trusted contact person. A member may elect to notify an individual that he or she was named as a trusted contact person; however, the rule does not require such notification."[40]

3. Regulators Urge Investors to Establish a Trusted Contact Person

FINRA, the North American Securities Administrators Association (NASAA), and the SEC's Office of Investor Education issued a joint press release on September 28, 2021, announcing "a new campaign urging investors to provide their financial firms with a trusted contact."[41] The press release notes that,

> "financial firms may reach out to trusted contacts only in limited circumstances, underscoring that a trusted contact:
>
> - Cannot make trades in the investor's account;
> - Cannot make decisions about the investor's account; and
> - Does not become a power of attorney, legal guardian, trustee or executor by virtue of being identified as a trusted contact."[42]

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[40] *SEC Adopts Rules Relating to Financial Exploitation of Seniors*, FINRA Regulatory Notice 17-11 (March 2017), *available at https://www.finra.org/sites/default/files/Regulatory-Notice-17-11.pdf*.

[41] Press Release, FINRA, NASAA and SEC OIEA Urge Investors to Establish a Trusted Contact to Increase Investor Protection (Sept 28, 2021), *available at* https://www.finra.org/media-center/newsreleases/2021/finra-nasaa-and-sec-oiea-urge-investors-establish-trusted-contact.

[42] *Id.*

D. FINRA Enforcement Precedent

While FINRA has brought numerous enforcement actions involving exploitation of seniors and vulnerable adults,[43] as of the date of this outline, there is only one trusted contact person case and no temporary hold on disbursements cases reported on FINRA's website, as summarized below.

	Case Name	Date of FINRA AWC or Decision	FINRA Disciplinary Sanction
1	Danielle Matson	June 23, 2021	21-calendar day suspension from associating with any FINRA member in all capacities and a $2,500 fine

1. **Danielle Matson** (June 23, 2021). The AWC alleges that, between August 2017 and April 2019, "on 16 occasions when updating a customer account profile, [Matson, a registered representative of RBC] falsely entered 'Less than $50,000' for the customer's liabilities and on 16 other occasions, she falsely entered 'None or none available' for the customer's trusted contact. These 32 entries were false, in that they did not represent the customers' liabilities or trusted contacts, and each of the entries became part of the customers' account record in the firm's books and records. No customer losses resulted from these entries." FINRA concluded that "[Matson] caused RBC to make and maintain inaccurate books and records in violation of §17(a) of the Exchange Act and Rule 17a-3 thereunder. In doing so, [Matson] violated FINRA Rules 4511 and 2010." Without admitting or denying the findings, Ms. Matson consented to a 21-calendar day suspension and a fine of $2,500.[44]

[43] *See, e.g., In the Matter of Department of Enforcement v. Austin Wayne Morton*, NAC Decision (Case No. 2016052347901) (May 15, 2019) (case dismissed; FINRA staff did not prove by a preponderance of evidence that a registered representative engaged in conversion; cites FINRA Rule 2165 and 4512 in footnote 56). *In the Matter of Department of Enforcement v. Joseph. R. Butler*, NAC Decision (Case No. 201203295010) (Sept. 25, 2015) (registered representative converted customer funds and submitted a false annuity beneficiary change request).

[44] FINRA AWC (Case No. 2019063728601), *available at*https://www.finra.org/sites/default/files/fda_documents/2019063728601%20Danielle%20Matson%20CRD%2041 40827%20AWC%20va%20%282021-1627086001219%29.pdf. This matter relates to trusted contact person information, however, the AWC alleges a violation of FINRA's general books and records requirements (Rule 4511) and not Rule 4512.

E. Proposed Amendment to FINRA Rule 2231 (Customer Account Statements)

1. SEC Proposal to Amend FINRA Rule 2231

On September 30, 2021, the SEC issued a notice of filing a proposed rule change to amend FINRA Rule 2231 (Customer Account Statements).[45] Among other proposed changes, FINRA proposed adding new supplementary materials pertaining to the transmission of customer account statements to other persons or entities and the use of electronic media to satisfy delivery obligations.

2. Rationale for Proposed Account Statement Change

The SEC release proposing the change explained the history behind the change, which began in 2009, and the senior investor concern, as follows:

> "***To address concerns regarding potential fraud, especially with senior investors***, where a third party receives the account statements in lieu of such customer, FINRA had also proposed clarifying that firms would have to continue to deliver account statements to customers, either in paper format or electronically, even when directed by the customer, in writing, to send statements to a third party. FINRA made this clarification in an effort to remain consistent with any SEC release, interpretation, "no-action" position or exemption issued by the SEC or its staff in the context of [Exchange Act] Rule 10b-10 (Confirmation of transactions) that have established the policy that customers should continue to receive periodic account statements when not receiving immediate trade confirmations under [Exchange Act] Rule 10b-10. Further comments were received in response to the Amended Rule Filing. Commenters objected to the proposed requirement to deliver account statements to customers even when directed by customers, in writing, to send the statements to third parties. Some commenters believed that members should not be required to continue delivering account statements to customers, particularly where there was a power of attorney ("POA") or incapacity. FINRA withdrew the filing to further consider the comments."[46]

Comments were due by October 21, 2021.

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[45] *Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 2231 (Customer Account Statements),* Exchange Act Release No. 93215 (Sept. 30, 2021), *available at* https://www.sec.gov/rules/sro/finra/2021/34-93215.pdf.

[46] *Id.* at pp. 6-7 (footnotes omitted).

CARLTON FIELDS

V. DIVERSITY, EQUITY, AND INCLUSION IN THE BROKER-DEALER INDUSTRY

A. <u>FINRA Regulatory Notice 21-17</u>[47]

On April 29, 2021, FINRA issued Regulatory Notice 21-17 seeking comments on "any aspects of [FINRA] rules, operations and administrative processes that may create unintended barriers to greater diversity and inclusion in the broker-dealer industry or that might have unintended disparate impacts on those within the industry."

Regulatory Notice 21-17 lists a number initiatives FINRA has undertaken, including the following:

- "establishing an internal Racial Justice Task Force, whose efforts include identifying opportunities to encourage greater diversity and inclusion within the broker-dealer industry, with the goal of better engaging traditionally underinvested communities and representing the needs of all investors;

- hosting an Annual Diversity Summit since 2013, where FINRA provides a forum for diversity practitioners and business leaders in the broker-dealer industry to share ideas and effective practices to promote inclusion in the workplace;

- creating diversity-focused programming at the FINRA Annual Conference since 2010, where FINRA's CEO hosts top keynote speakers and industry panelists to discuss perspectives and insights on the importance of ensuring that diversity and inclusion remain a key commitment within firms in the broker-dealer industry;

- developing the Securities Industry Essentials (SIE) Exam to expand who is eligible to take a qualification examination and to enable prospective broker-dealer industry professionals to demonstrate to potential employers a basic level of securities industry knowledge prior to a job application, including concepts fundamental to working in the industry (*e.g.*, types of products and their risks); the structure of the securities industry markets, regulatory agencies and their functions; and prohibited practices. Individuals taking the SIE do not need to be associated with a FINRA member firm and a passing result on the SIE is valid for four years. This

[47] *Diversity and Inclusion: FINRA Seeks Comment on Supporting Diversity and Inclusion in the Broker-Dealer Industry*, FINRA Regulatory Notice 21-17 (April 28, 2021), *available at* https://www.finra.org/sites/default/files/2021-04/Regulatory-Notice-21-17.pdf.

approach allows for more flexibility and career mobility within the broker-dealer industry. In promoting the SIE, FINRA has particularly emphasized outreach to historically Black colleges and universities and other minority-serving and diversity-focused organizations to expand the pool of candidates and registered persons; and

- proposing to implement the recommendations of the Securities Industry/Regulatory Council on Continuing Education regarding enhancements to the continuing education program for broker-dealer industry professionals. These enhancements include enabling individuals who terminate their registrations to maintain their qualification by completing continuing education, in order to allow individuals to better manage significant life events, such as professional changes and development (*e.g*., pursuing educational goals, a career change to a role in the firm that is not part of the broker-dealer, working overseas for an extended period due to a career change or an attempt at a different career path) or personal life events (*e.g.*, birth or adoption of a child, unexpected loss in the family or relocation due to family needs)."[48]

FINRA sought comment on five questions. The comment period ended on June 28, 2021, and FINRA received 33 comment letters.

VI. BROKER-DEALER RESPONSIBILITIES WHEN OUTSOURCING TO A THIRD-PARTY SERVICE PROVIDER

A. FINRA Regulatory Notice 21-29[49]

On August 13, 2021, FINRA issued Regulatory Notice 21-29 (Notice) to remind firms of their supervisory obligations related to outsourcing to third-party vendors. The Notice updates FINRA's guidance on outsourcing in Notice to Members 05-48 (2005) and reiterates applicable regulatory obligations; summarizes recent trends in examination findings, observations and disciplinary actions; and provides questions member firms may consider when evaluating their systems, procedures and controls relating to vendor management.

The Notice outlines regulatory obligations, examination findings for several years, related disciplinary actions in which firms did not supervise vendors, and questions for consideration. An appendix to the Notice links to helpful FINRA

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[48] *Id.* (footnotes omitted).

[49] *Vendor Management and Outsourcing,* FINRA Regulatory Notice 21-29 (Aug. 13, 2021), *available at* https://www.finra.org/sites/default/files/2021-08/Regulatory-Notice-21-29.pdf.

guidance relating to outsourcing, vendor management, and supervisory responsibilities.

The Notice outlines broker-dealer regulatory obligations relating to outsourcing activities to third-party vendors as follows (internal footnotes omitted):

Category	Summary of Regulatory Obligations
Supervision	FINRA Rule 3110 (Supervision) requires member firms to establish and maintain a system to supervise the activities of their associated persons ***that is reasonably designed to achieve compliance*** with federal securities laws and regulations, as well as FINRA rules, including maintaining written procedures to supervise the types of business in which it engages and the activities of its associated persons. This supervisory obligation extends to member firms' outsourcing of certain "covered activities"—activities or functions that, if performed directly by a member firm, would be required to be the subject of a supervisory system and WSPs pursuant to FINRA Rule 3110. *Notice* 05-48 reminds member firms that "outsourcing an activity or function to … [a Vendor] does not relieve members of their ultimate responsibility for compliance with all applicable federal securities laws and regulations and [FINRA] and MSRB rules regarding the outsourced activity or function." Further, *Notice* 05-48 states that if a member outsources certain activities, "the member's supervisory system and [WSPs] must include procedures regarding its outsourcing practices to ensure compliance with applicable securities laws and regulations and [FINRA] rules." FINRA expects member firms ***to develop reasonably designed supervisory systems*** appropriate to their business model and scale of operations that address technology governance-related risks, such as those inherent in firms' change and problem-management practices. Failure to do so can expose firms to operational failures that may compromise their ability to serve their customers or comply with a range of rules and regulations, including FINRA Rules 4370 (Business Continuity Plans and

Category	Summary of Regulatory Obligations
	Emergency Contact Information), 3110 (Supervision) and books and records requirements under 4511 (General Requirements), as well as Exchange Act Rules 17a-3 and 17a-4.
Registration	*Notice* 05-48 reminds firms that, "in the absence of specific [FINRA] rules, MSRB rules, or federal securities laws or regulations that contemplate an arrangement between members and other registered broker-dealers with respect to such activities or functions (*e.g.*, clearing agreements executed pursuant to [FINRA Rule 4311]), any third-party service providers conducting activities or functions that require registration and qualification under [FINRA] rules will generally be considered associated persons of the member and be required to have all necessary registrations and qualifications." Accordingly, firms must review whether Vendors or their personnel meet any registration requirements under FINRA Rule1220 (Registration Categories), as well as whether employees of the member firm are "Covered Persons" under the Operations Professional registration category pursuant to FINRA Rule 1220(b)(3), due to their supervision of "Covered Functions" executed by a Vendor or because they are authorized or have the discretion materially to commit the member firm's capital in direct furtherance of a Covered Function or to commit the member firm to any material contract or agreement (written or oral) with a Vendor in furtherance of a Covered Function.
Cybersecurity	SEC Regulation S-P Rule 30 requires broker-dealers to have written policies and procedures that address administrative, technical and physical ***safeguards for the protection of customer records and information that are reasonably designed to***: (1) ensure the security and confidentiality of customer records and information; (2) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.

Category	Summary of Regulatory Obligations
	FINRA expects member firms ***to develop reasonably designed cybersecurity programs and controls*** that are consistent with their risk profile, business model and scale of operations. FINRA reminds member firms to review core principles and effective practices for developing such programs and controls, including Vendor management, from FINRA's Report on Cybersecurity Practices (2015 Report) and the Report on Selected Cybersecurity Practices – 2018 (2018 Report), as well as other resources included in the Appendix to this *Notice*.
Business Continuity Planning (BCP)	FINRA Rule 4370 (Business Continuity Plans and Emergency Contact Information) requires member firms to create and maintain a written BCP with ***procedures that are reasonably designed to*** enable member firms to meet their existing obligations to customers, counterparties and other broker-dealers during an emergency or significant business disruption. The elements of each member firm's BCP—including their use of Vendors—can be "flexible and may be tailored to the size and needs of a member [firm]," provided that minimum enumerated elements are addressed. As a reminder, member firms must review and update their BCPs, if necessary, in light of changes to member firms' operations, structure, business or location.

If a broker-dealer is considering outsourcing activities to a third-party vendor, FINRA suggests evaluating a list questions in the context of a risk-based approach to vendor management. The Notice identifies four phases of a firm's outsourcing activities, as follows:

- "deciding to outsource an activity or function,
- conducting due diligence on prospective Vendors,
- onboarding Vendors, and
- overseeing or supervising outsourced activities or functions."[50]

[50] *Id.*

The questions set forth in the Notice fall into the following categories: decision to outsource, due diligence, conflicts of interest, and cybersecurity. FINRA notes as follows: "Factors firms may take into consideration include, but are not limited to:

- Will the Vendor be handling sensitive firm or customer non-public information?
- What would be the extent of the potential damage if there is a security breach (*e.g.,* number of customers or prospective customers impacted)?
- Is the Vendor performing a business-critical role or fulfilling a regulatory requirement for the firm?
- What is the reputation and history of the Vendor, including the representations made and information shared on how the Vendor will secure the firm's information?"

VII. DIGITAL ASSETS

A. FINRA Regulatory Notice 21-25[51]

1. Digital Asset Defined

FINRA defines the term "digital asset" as follows:

> "cryptocurrencies and other virtual coins and tokens (including virtual coins and tokens offered in an initial coin offering (ICO) or pre-ICO), and any other asset that consists of, or is represented by, records in a blockchain or distributed ledger (including any securities, commodities, software, contracts, accounts, rights, intangible property, personal property, real estate or other assets that are "tokenized," "virtualized" or otherwise represented by records in a blockchain or distributed ledger)."[52]

2. Types of Digital Activities of Interest to FINRA

To the extent a firm is engaged in one or more of the following activities, FINRA has advised that the firm should contact its risk monitoring analyst:

[51] *FINRA Continues to Encourage Firms to Notify FINRA if They Engage in Activities Related to Digital Assets,* FINRA Regulatory Notice 21-25 (July 8, 2021), *available at* https://www.finra.org/sites/default/files/2021-07/Regulatory-Notice-21-25.pdf.

[52] *Id.* at n. 2.

- purchases, sales or executions of transactions in digital assets;
- purchases, sales or executions of transactions in a pooled fund investing in digital assets;
- creation of, management of, or provision of advisory services for, a pooled fund related to digital assets;
- purchases, sales or executions of transactions in derivatives (*e.g.*, futures, options) tied to digital assets;
- participation in an initial or secondary offering of digital assets (*e.g.*, ICO, pre-ICO);
- creation or management of a platform for the secondary trading of digital assets;
- custody or similar arrangement of digital assets;
- acceptance of cryptocurrencies (*e.g.*, bitcoin) from customers;
- mining of cryptocurrencies;
- recommend, solicit or accept orders in cryptocurrencies and other virtual coins and tokens;
- display indications of interest or quotations in cryptocurrencies and other virtual coins and tokens;
- provide or facilitate clearance and settlement services for cryptocurrencies and other virtual coins and tokens; or
- recording cryptocurrencies and other virtual coins and tokens using distributed ledger technology or any other use of blockchain technology."[53]

3. Notify Risk Monitoring Analyst (FKA Regulatory Coordinator)

Digital asset activities continue to grow. For four years in a row FINRA has issued Regulatory Notices to encourage firms "to keep their ***risk monitoring analyst informed*** if the ***firm, or its associated persons*** or affiliates, engaged, or intended to engage, in activities related to digital assets, including digital assets that are non-securities."[54] Depending on the size of the firm, gathering and reporting digital asset activity of each associated person and affiliate can be a monumental undertaking, particularly when FINRA's digital asset notices do not explain why FINRA is seeking this information, what FINRA will do with the information, or what FINRA will do if a firm does not report the information. While not expressed in the notices, possible reasons FINRA seeks digital asset information may include:

[53] *Id.*

[54] *Id.*; *see also* FINRA Regulatory Notices 18-20, 19-24, and 20-23.

- digital asset information provides FINRA with an opportunity to confirm whether a firm's digital asset activity is an approved activity of the firm and/or represents a material change in the firm's approved business operations, and

- digital asset information provides a means for FINRA to monitor firms' activity, including whether digital asset activity raises securities status issues.

FINRA's digital asset Regulatory Notices raise, but do not answer, some very basic questions. For example:

- what is FINRA's goal in collecting this information?

- what regulatory purpose is served by contacting a firm's risk monitoring analyst to report digital asset information?

- what action does FINRA expect risk monitoring analysts to take upon receipt of this information?

VIII. COMMUNICATIONS WITH THE PUBLIC

This Sections of this outline address developments relating to FINRA's communications with the public rules. Keeping with the theme of this outline, FINRA's communication with the public rules for the most part do not explicitly use variants of the term "reasonable," however, the words that are used – "fair and balanced" – implicitly connote reasonableness.

A. Use of Hyperlinks in Electronic Communications

1. Background

FINRA Rule 2210(d)(1)(B) states as follows:

"No member may make any false, exaggerated, unwarranted, promissory or misleading statement or claim in any communication. No member may publish, circulate or distribute any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading."

2. New FINRA Guidance

On September 30, 2021, FINRA issued new guidance on the use of hyperlinks in a firm's electronic communications, as follows:

"D.5.1. Q. Does FINRA Rule 2210(d)(1)(A) permit a firm to include in electronic communications hyperlinks to content that provides additional information related to the communication in a fair and balanced manner?

A: Yes. FINRA Rule 2210(d)(1)(A) requires firm communications, among other things, to be fair, balanced, and not to omit any material fact or qualification if the omission would cause the communication to be misleading. Consistent with these standards, ***a firm may rely on a hyperlink to provide additional information or explanations so long as the initial electronic communication that includes the link is itself fair and balanced***. For example, a non-misleading electronic communication about opportunities in emerging markets could link to an additional explanation about the basis for a claim in the initial post as well as the risks associated with emerging markets investments. However, a firm may not rely on linked explanations or disclosures to correct a communication that is, on its face false, misleading, exaggerated or promissory. To the extent practicable in the given medium, the link itself, or the text within the communication that introduces the link, should state what will be provided through the link.

Historically, FINRA has interpreted the Communications with the Public Rules to permit hyperlinks to explanations and further information in a variety of situations. For example, FINRA Rule 2210 permits firms to use hyperlinks within banner advertisements to generate interest in a topic and provide more information through hyperlinks, and FINRA has interpreted FINRA Rule 2210 to permit firms to link to required information about testimonials.

This approach is also consistent with the treatment of hyperlinks in the Commission's recently adopted Investment Adviser Marketing rule under the Investment Advisers Act of 1940 [(Advisers Act)]. The Marketing Rule Adopting Release notes that the rule's use of "fair and balanced" is closely aligned with FINRA Rule 2210's general standards, and that investment advisers may use layered disclosure that employ[s] hyperlinks to meet these requirements."[55]

[55] Frequently Asked Questions about Advertising Regulation, FAQ 5.D.1. (Sept. 30, 2021) (footnotes omitted), *available at* https://www.finra.org/rules-guidance/guidance/faqs/advertising-regulation#d5. [Hereinafter, Advertising FAQs]. Among other topics updated on September 30, 2021, the Advertising Department issued new FAQs pertaining to public appearances, videos posted online, internal rate of return, and online presentations hosted by a third party. *Id.*

3. Source of the Hyperlinked Material

The new hyperlink FAQ is unclear on the required source of the hyperlinked information. Presumably FAQ D.5.1. relates to linked information supplied by the firm in lieu of including the information in the text of the electronic communication. But if the hyperlink is to information supplied by a third party, the SEC's guidance on "adoption theory" and/or "entanglement theory" could apply.[56]

4. Links to Third-Party Information – Adoption and Entanglement

FINRA addressed the adoption and entanglement theories in a social media FAQ on third-party posts over a decade ago, as follows:

> **Q8:** If a customer or other third party posts content on a social media site established by the firm or its personnel, does FINRA consider the third-party content to be the firm's communication with the public under Rule 2210?
>
> **A8:** As a general matter, FINRA does not treat posts by customers or other third parties as the firm's communication with the public subject to Rule 2210. Thus, the prior principal approval, content and filing requirements of Rule 2210 do not apply to these posts.
>
> ***Under certain circumstances, however, third-party posts may become attributable to the firm.*** Whether third-party content is attributable to a firm depends on whether the firm has (1) involved itself in the preparation of the content or (2) explicitly or implicitly endorsed or approved the content.
>
> The SEC has referred to circumstance (1) above as the "***entanglement" theory (i.e., the firm or its personnel is entangled with the preparation of the third-party post) and (2) as the "adoption" theory (i.e., the firm or its personnel has adopted its content).*** Although the SEC has employed these theories as a basis for a company's responsibility for third-party information that is ***hyperlinked to its Web site***, a similar analysis would apply to third-party posts on a social media site established by the firm or its personnel.
>
> For example, FINRA would consider such a third-party post to be a communication with the public by the firm or its personnel under the entanglement theory if the firm or its personnel paid for or otherwise was

[56] *See Commission Guidance on the Use of Company Web Sites,* Exchange Act Release No. 58288 (Aug. 1, 2008); *Use of Electronic Media,* Securities Act Release No. 7856 (April 28, 2000).

involved with the preparation of the content prior to posting. FINRA also would consider a third-party post to be a communication with the public by the firm or its personnel under the adoption theory if, after the content is posted, the firm or its personnel explicitly or implicitly endorses or approves the post."[57]

B. Back-Tested Performance

1. What is back-tested performance?

a. The SEC enforcement staff has defined back-tested performance as follows:

> "'Back-testing' involves the retroactive application of an investment strategy or methodology to a historical set of data. Back-tested performance attempts to indicate how a product constructed with the benefit of hindsight would have performed during a certain period in the past if the product had been in existence during that time. In other words, how the model would have performed during a time period before the model was actually created. Back-tested performance carries the risk of "data mining." That is, with the benefit of hindsight, the back-tester may examine multiple strategies and selectively pick one that works very well for the specific time period being tested. This process elevates the risk that reports of positive performance will simply be the result of hindsight, and may not reflect any true success in predictive modeling for future investments."[58]

b. FINRA has defined back-tested performance as follows:

> "Hypothetical back-tested performance attempts to show how a portfolio or index constructed with the benefit of hindsight would have performed during a certain period in the past if the product or index had been in existence during such time. Back-tested performance differs from historical performance in that historical performance measures how a portfolio or index actually performs

[57] *Guidance on Blogs and Social Networking Websites*, FINRA Regulatory Notice 10-06 (Jan. 2010) (footnotes omitted), *available at* https://www.finra.org/sites/default/files/NoticeDocument/p120779.pdf.

[58] *SEC v. Navellier & Associates, Inc., et al.*, Complaint, U.S.D.C. for the D. of Mass. (Aug. 31, 2017) at ¶ 40, *available at* https://www.sec.gov/litigation/complaints/2017/comp23925.pdf.

after the investment allocation decisions have been made, without the benefit of hindsight."[59]

2. Prohibition on Predictions or Projections of Investment Performance

Historically, FINRA has prohibited the use of back-tested performance in communications with retail investors. In another context, FINRA recently issued FAQ guidance addressing the prohibition on predictions or projections of investment performance. While the question was asked in the context of private placement communications, the FAQ expresses FINRA's views on a type of back-testing:

> **"D.7.1 Q. May a firm include in a private placement communication a 'target return' if the communication also includes the assumptions and key risks underlying the return?**
>
> A. No. FINRA Rule 2210(d)(1)(F) prohibits predictions or projections of performance, the implication that past performance will recur, and any exaggerated or unwarranted claim, opinion or forecast. Targeted returns reflect the assumed receipt of future cash flows by investors and are not guaranteed. These returns may include cash flows based on contractual sources of revenue such as master lease agreements or sales contracts. Such forward-looking cash flows necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking metrics. Given the prohibition on predictions or projections, firms may not include any metrics reflecting targeted returns to investors in communications concerning private placements."[60]

3. Investment Adviser Marketing – Hypothetical Performance

On March 5, 2021, the SEC adopted amendments to the rules under the Advisers Act to update Rule 206(4)-1 governing investment adviser marketing.[61] The updated rule became effective on May 4, 2021. While

[59] *FINRA Requests Comments on Proposed Amendments to Rules Governing Communications with the Public*, FINRA Regulatory Notice 17-06 (Feb. 2017), at n. 8, *available at* https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-06.pdf.

[60] Advertising FAQs, *supra* note 55, at FAQ D.7.1.

[61] *Investment Adviser Marketing*, Advisers Act Release No. 5653 (March 5, 2021) (footnotes omitted) (emphasis added), *available at* https://www.sec.gov/rules/final/2020/ia-5653.pdf.

the Advisers Act marketing rule is not the subject of this outline, it is worth noting that the amended rule defines "hypothetical performance" in part to include "certain backtested performance." In adopting the rule, the SEC noted as follows:

> "*Backtested Performance*. As proposed, the final rule will treat backtested performance as a type of hypothetical performance. We proposed to include '[p]erformance that is backtested by the application of a strategy to market data from prior periods when the strategy was not actually used during those periods.' . . .
>
> We acknowledge that backtested performance may help investors understand how an investment strategy may have performed in the past if the strategy had existed or had been applied at that time. In addition, this type of performance information may demonstrate how the adviser adjusted its model to reflect new or changed data sources. While we understand the potential value of such data to investors, backtested performance information also has the potential to mislead investors. ***Because this performance is calculated after the end of the relevant period, it allows an adviser to claim credit for investment decisions that may have been optimized through hindsight, rather than on a forward-looking application of stated investment methods or criteria and with investment decisions made in real time and with actual financial risk.*** For example, an investment adviser is able to modify its investment strategy or choice of parameters and assumptions until it can generate attractive results and then present those as evidence of how its strategy would have performed in the past.
>
> We believe that backtested performance included in an advertisement is more likely to be misleading to the extent that the intended audience does not have the resources and financial expertise to assess the hypothetical performance presentation. The conditions that the final rule will impose on displays of hypothetical performance in advertisements are designed ***to ensure that advisers present backtested performance in a manner that is appropriate for the advertisement's intended audience***.
>
> In response to a commenter's suggestion, the final rule will apply to advertisements including presentations of performance that is backtested by the application of a strategy to data from prior time periods when the strategy was not actually used during those time periods, instead of applying only to application of the strategy to ''market'' data from a prior time period. Accordingly, the

hypothetical performance provisions will apply to presentations of both market and non-market data in advertisements. This change will account for scenarios where an adviser could backtest performance based on non-market data (*e.g.*, data from other portfolios managed by the adviser). We are otherwise adopting this provision as proposed."[62]

4. FINRA Regulatory Notice 17-06[63]

a. Proposed Amendments

In 2017, FINRA proposed amendments to Rule 2210 to "create an exception to the rule's prohibition on projecting performance to permit a firm to distribute a ***customized hypothetical investment planning illustration*** that includes the projected performance of an asset allocation or other investment strategy, but not an individual security, subject to specified conditions." FINRA received comments, but the proposed amendments have not been adopted.

b. Reasonable Basis Test for Assumptions

The proposal included a requirement that there be ***a "reasonable basis" for all assumptions***. Regulatory Notice 17-06 described the proposal as follows:

> "The proposal would provide an exception to the prohibition of projections for a customized hypothetical investment planning illustration. The exception would be available for all firms, including firms that operate only an online platform, and could be used with both current and prospective customers. ***The illustration may project an asset allocation or other investment strategy, but not the performance of an individual security.*** The proposal would require that there be a ***reasonable basis*** for all assumptions, conclusions and recommendations, and that the illustration clearly and prominently disclose the fact that the illustration is hypothetical and there is no assurance that any described investment performance or event will occur. All material assumptions and limitations applicable to the illustration would have to be disclosed.

[62] *Id.*

[63] FINRA Regulatory Notice 17-06, *supra* note 59 (footnotes omitted) (emphasis added).

The "reasonable basis" requirement follows well-established precedents. FINRA Rules 2210 and 2241 (Research Analysts and Research Reports) require a price target in a research report to have a reasonable basis. SEC rules also require performance projections contained in offering documents or prospectuses to be based on good faith and have a reasonable basis.

A "reasonable basis" might be established, for example, by reference to the historical performance and performance volatility of asset classes, the duration of fixed income investments, the effects of macroeconomic factors such as inflation and changes in currency valuation, the impact of fees, costs and taxes, and expected contribution and withdrawal rates by the customer. An unreasonable emphasis on any one of these factors might cause the projection to be noncompliant. Moreover, basing a projection upon hypothetical back-tested performance (which FINRA has interpreted the communications rules to prohibit in retail communications) or the past performance of particular investments by an asset manager would not be reasonable."[64]

c. Next Steps

It is not yet known whether FINRA will pursue the amendments proposed in 2017. Following the SEC's adoption of the Investment Adviser Marketing Rule, however, FINRA may decide to take another look at the regulatory landscape for backtested performance and model performance.

C. Registered Index Linked Annuity (RILA) Illustrations

1. Background

H.R. 4865, a bill to direct the SEC "to revise any rules necessary to enable issuers of index-linked annuities to register on a form tailored specifically to registered index-linked annuities" defines RILA as follows:

"(A) is deemed a security;

(B) is required to be registered with the Securities and Exchange Commission;

[64] *Id.*

(C) is issued by an insurance company that is subject to the supervision of the insurance commissioner of the applicable State;

(D) is not issued by an investment company; and

(E) the returns of which—

(i) are based on the performance of a specified benchmark or rate; and

(ii) may be subject to a market value adjustment if amounts are withdrawn prior to the end of the period during which such adjustment applies."[65]

2. Free Writing Prospectus

An insurance company sales piece relating to RILAs is filed with the SEC pursuant to Rule 433 under the Securities Act as a free writing prospectus. A free writing prospectus is any communication that is both an offer to sell or solicitation of an offer to buy SEC-registered securities that is used after a registration statement for the security is filed (unless the issuer is a well-known seasoned issuer (WKSI) whether or not a registration statement has been filed). FINRA does not review free writing prospectus material.

3. RILA and Index Product Illustrations Reviewed by FINRA

FINRA has had occasion to review RILA illustrations in the context of combination products (variable annuity and RILA) pieces submitted for review by the Advertising Department. FINRA also has reviewed variable index life illustrations. FINRA does not permit backtested performance in retail communications, including in RILA illustrations. However, FINRA has permitted index performance in hypothetical RILA illustrations to act as a proxy for investment performance. FINRA does not permit custom indices to be illustrated.

[65] Registration for Index-Linked Annuities Act, H.R. 4865, 117 Congress, Section 2(a)(5) (July 31, 2021), *available at* https://www.govtrack.us/congress/bills/117/hr4865/text/ih. *See also* Registered Index-Linked Annuities, Annuity.org, *available at* https://www.annuity.org/annuities/types/registered-index-linked-annuities/ ("A registered index-linked annuity, or RILA, is an annuity that uses a stock market index to determine gains and losses. What sets it apart from other types of annuities is your ability to set the maximum loss you are willing to tolerate. RILAs give you the opportunity to own an investment vehicle with the risk/reward characteristics that meet your overall financial objectives.").

D. Communications that Promote or Recommend Private Placements

1. Amendment to Rule 5122 (Private Placements of Securities Issued by Members)

Rule 5122 applies to private placements of unregistered securities issued by a FINRA member broker-dealer or a control entity (so-called member private offerings). Pursuant to Rule 5122(a)(2), a "control entity" means any entity that controls or is under common control with a FINRA member broker-dealer, or that is controlled by a member or its associated persons.[66]

Rule 5122 requires the broker-dealer or control entity to provide prospective investors with a private placement memorandum (PPM), term sheet, or other offering document that discloses the intended use of the offering proceeds, the offering expenses and the amount of selling compensation that will be paid to the broker-dealer and its associated persons. Rule 5122 also requires a broker-dealer to file the PPM, term sheet or other offering document with the FINRA Corporate Financing Department (Corp Fin) at or prior to the first time the document is provided to any prospective investor.

Among others, the following private placements are exempt from the requirements of Rule 5122:

- offerings sold only to institutional accounts, as defined in FINRA Rule 4512(c),
- qualified purchasers, as defined in the Investment Company Act of 1940 (1940 Act), and
- qualified institutional buyers, as defined in Rule 144A under the Securities Act.

2. Amendment to Rule 5123 (Private Placements of Securities)

Rule 5123 requires broker-dealers to file with FINRA any PPM, term sheet or other offering document, including any material amended versions thereof, used in connection with a private placement of securities within 15 calendar days of the date of first sale. Rule 5123 exempts private placements that are

[66] As noted in FINRA Regulatory Notice 21-26 (July 15, 2021), "Control means beneficial interest, as defined in FINRA Rule 5130(i)(1), of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership or other non-corporate legal entity. Control is determined immediately after the closing of an offering, and in the case of an offering with multiple intended closings, immediately following each closing." FINRA Rule 5122(a)(3).

filed under other FINRA Corporate Financing Rules, as well as most of the same categories of private placements that are exempt from filing under Rule 5122.

FINRA observes in Regulatory Notice 21-26: "As a result of these exemptions, both Rule 5122 and Rule 5123 apply predominately to private placements sold to retail investors.

3. FINRA Regulatory Notice 21-26[67]

On July 15, 2021, FINRA issued Regulatory Notice 21-21 to remind firms about changes to FINRA Rules 5122 and 5123 that require broker-dealers "to file retail communications that promote or recommend private placement offerings that are subject to those rules' filing requirements." The new filing requirements became effective on October 1, 2021.

IX. CONCLUSION

Whether your work involves SEC or FINRA regulatory matters, I hope you find this outline helpful. Anticipating that some practitioners might question the value of a 42-page outline without an appendix, I have added a 15-page appendix containing variants of the term "reasonable" in the rules and guidance of the SEC and FINRA. It is, after all, only reasonable.

A.B.F.
10/26/21

[67] *Private Placement Retail Communications*, Regulatory Notice 21-26 (July 15, 2021), *available at* https://www.finra.org/sites/default/files/2021-07/Regulatory-Notice-21-26.pdf.

APPENDIX A

Variants of "Reasonable" in the Rules and Guidance of the SEC and FINRA

The following table sets forth, in chronological order, uses of the terms "reasonable," "reasonably," and "reasonableness" in SEC and FINRA rules and guidance, as well as case law and regulator speeches. This list is for illustration purposes and is not intended to be a comprehensive list of every instance in which regulators have used variants of the term.

Date	"Reasonable," "Reasonably," "Reasonableness"	Source
June 14, 1976	"The general standard of materiality that we think best comports with the policies of Rule 14a-9 is as follows: An omitted fact is material if there is ***a substantial likelihood that a reasonable shareholder would consider it important*** in deciding how to vote. . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would ***have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available***."	*TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976)
Oct. 11, 1996	**Investment Company Act Section 26(f)(2)(A)** **"2) Limitation on sales** It shall be unlawful for any registered separate account funding variable insurance contracts, or for the sponsoring insurance company of such account, to sell any such contract— **(A)** unless the fees and charges deducted under the contract, in the aggregate, ***are reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by*** the insurance company, and, beginning on the earlier of August 1, 1997, or the earliest effective date of any registration statement or amendment thereto for such contract following October 11, 1996, the insurance company so represents in the registration statement for the contract; and . . ."	National Securities Markets Improvements Act of 1996 (NSMIA), enacted as Section 26(e) of the 1940 Act, later changed to 26(f) https://www.govinfo.gov/content/pkg/BILLS-104hr3005enr/html/BILLS-104hr3005enr.htm

Date	"Reasonable," "Reasonably," "Reasonableness"	Source
Dec. 17, 2003	**Investment Company Act Rule 38a-1**: "(a) Each registered investment company and business development company ('fund') must: (1) *Policies and procedures*. Adopt and implement written policies and procedures ***reasonably designed to prevent violation of the Federal Securities Laws*** by the fund, including policies and procedures that provide for the oversight of compliance by each investment adviser, principal underwriter, administrator, and transfer agent of the fund;" **Investment Advisers Act Rule 206(4)-7**: "If you are an investment adviser registered or required to be registered under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3), it shall be unlawful within the meaning of section 206 of the Act (15 U.S.C. 80b-6) for you to provide investment advice to clients unless you: (a) *Policies and procedures*. Adopt and implement written policies and procedures ***reasonably designed to prevent violation, by you and your supervised persons,*** of the Act and the rules that the Commission has adopted under the Act."	*Final Rule: Compliance Programs of Investment Companies and Investment Advisers*, Investment Company Act Release No. 26299 and Advisers Act Release No. 2204 (Dec. 17, 2003) http://www.sec.gov/rules/final/ia-2204.htm
Jan. 2010	**FINRA Rule 2330, Supplementary Material** **".05 Gathering of Information Regarding Customer Exchanges.** Rule 2330 requires that the member or person associated with a member consider whether the customer has had another deferred variable annuity exchange within the preceding 36 months. Under this provision, a member or person associated with a member must determine whether the customer has had such an exchange at the member ***and must make reasonable efforts to ascertain whether the customer has had an exchange*** at any other broker-dealer within the preceding 36 months. ***An inquiry to the customer as to whether the customer has had an exchange at another broker-dealer within 36 months would***	*Deferred Variable Annuities, FINRA Reminds Firms of Their Responsibilities Under FINRA Rule 2330 for Recommended Purchases or Exchanges of Deferred Variable Annuities*, FINRA Regulatory Notice 10-05 https://www.finra.org/sites/default/files/NoticeDocument/p120756.pdf

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	constitute a "reasonable effort" in this context. Members shall document in writing both the nature of the inquiry and the response from the customer."	
Dec. 14, 2011	**The Private Placement Market** "As a response to these problems, in 2010 FINRA issued guidance to firms concerning their participation in Regulation D offerings. The *Notice* reminded firms that FINRA's suitability rule requires that a broker-dealer ***conduct a "reasonable investigation" concerning recommended Regulation D offerings***. The guidance also made clear that the requirement to conduct ***a reasonable investigation is a duty of a broker-dealer*** that arises from a long history of case law under the antifraud provisions, and under FINRA's just and equitable principles of trade. This duty requires the ***broker-dealer to understand the Regulation D securities and to take reasonable steps to ensure that the customer understands the risks and essential features of those securities.***"	Stephen Luparello, Vice Chairman, FINRA, Testimony Before the Subcommittee on Securities, Insurance, and Investment, United States Senate https://www.finra.org/media-center/speeches-testimony/testimony-subcommittee-securities-insurance-and-investment-0
Oct. 12, 2012	"Sections 15(b)(4)(E) and 15(b)(6)(A) of the Securities Exchange Act authorize the Commission to impose sanctions on ***a broker-dealer or any person that fails to reasonably supervise someone that is subject to the supervision*** of such firm or person who violates the federal securities laws. Section 203(e)(6) of the Advisers Act has a similar provision for investment advisers. "Under the Investment Advisers Act ***an investment adviser is subject to liability for failure reasonably to supervise persons*** subject to its supervision, with a view to preventing violations of the federal securities laws." Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, at 35, *available at* http://www.sec.gov/news/studies/2011/913studyfinal.pdf."	*Conflicts of Interest and Risk Governance*, Carlo di Florio, Director, Office of Compliance Inspections and Examinations, Speech before the National Society of Compliance Professionals https://www.sec.gov/news/speech/2012-spch103112cvdhtm

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Sept. 11, 2014	"Next month marks the ten-year anniversary of the compliance date for Rule 206(4)-7 – the compliance program rule under the Advisers Act. As you are no doubt aware, Rule 206(4)-7 requires registered advisers ***to adopt, implement and annually review compliance policies and procedures that are reasonably designed to prevent violations of the Advisers Act***."	Norm Champ, Remarks before the Practising Law Institute Hedge Fund Management Seminar 2014 https://www.sec.gov/news/speech/2014-spch091114nc
Feb. 2017	"A "***reasonable basis"*** might be established, for example, by reference to the historical performance and performance volatility of asset classes, the duration of fixed income investments, the effects of macroeconomic factors such as inflation and changes in currency valuation, the impact of fees, costs and taxes, and expected contribution and withdrawal rates by the customer. ***An unreasonable emphasis*** on any one of these factors might cause the projection to be noncompliant. Moreover, basing a projection upon hypothetical back-tested performance (which FINRA has interpreted the communications rules to prohibit in retail communications) or the past performance of particular investments by an asset manager ***would not be reasonable.***"	*FINRA Requests Comments on Proposed Amendments to Rules Governing Communications with the Public*, FINRA Regulatory Notice 17-06 (Feb. 2017) https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-06.pdf.
March 2017	"The amendments to Rule 4512 and new Rule 2165 provide members with a way under FINRA rules to respond to situations in which ***they have a reasonable basis to believe that financial exploitation has occurred, is occurring, has been attempted or will be attempted***. The amendments to Rule 4512 require members to ***make reasonable efforts to obtain the name of and contact information for a trusted contact person*** upon the opening of a non-institutional customer's account or when updating account information for a noninstitutional account in existence prior to the effective date of the amendments (existing account).	*Financial Exploitation of Seniors*, FINRA Regulatory Notice 17-11(footnotes omitted) https://www.finra.org/sites/default/files/Regulatory-Notice-17-11.pdf

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	Rule 2165 permits, under FINRA rules, a member that ***reasonably believes that financial exploitation has occurred, is occurring, has been attempted or will be attempted to place a temporary hold on the disbursement*** of funds or securities from the account of a "specified adult" customer."	
June 12, 2017	"A firm's obligations start with the hiring process. As a general matter, FINRA requires that member firms investigate and ascertain the good character, business reputation, qualifications, and experience of an individual broker before they register that broker with FINRA. A firm must obtain all the necessary information to determine whether it should associate with a particular individual, and we recently strengthened the background check obligations of firms: they are now required to ***adopt written procedures reasonably designed to verify the accuracy and completeness of the information*** contained in a broker's mandated disclosure forms. A firm's verification process must, at a minimum, provide for ***a national search of reasonably available public records*** conducted by the firm or a third-party service provider to verify the accuracy and completeness of the information. Once an individual is hired***, reasonable supervision is critical.*** FINRA requires firms to establish and maintain supervisory systems for each of their brokers and to test and verify annually that they ***have established reasonable procedures.*** Firms must ensure that supervisors have the requisite knowledge and experience to review the specific business activities of their brokers."	Robert W. Cook, President and CEO, FINRA, *Protecting Investors From Bad Actors*, Speech at Georgetown University https://www.finra.org/media-center/speeches-testimony/protecting-investors-bad-actors
Jan. 3, 2018	**"Q.1.1. May a member place a temporary hold on a securities transaction pursuant to Rule 2165?** No. Rule 2165 provides a safe harbor for a member to place a temporary hold on a disbursement of funds or securities from the account of a specified adult if the member	Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors https://www.finra.org/rules-guidance/guidance/faqs/frequen

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	reasonably believes that financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted. Rule 2165 does not apply to transactions in securities. For example, Rule 2165 would not apply to a customer's order to sell his shares of a stock. However, if a customer requested that the proceeds of a sale of shares of a stock be disbursed out of his account at the member, then Rule 2165 could apply to the disbursement of the proceeds where the customer is a specified adult and ***there is reasonable belief of financial exploitation***." **"Q.4.3. Does Rule 4512 require that a customer provide the trusted-contact information?** No. Supplementary Material .06(b) to Rule 4512 states that "the absence of the name of or contact information for a trusted contact person shall not prevent a member from opening or maintaining an account for a customer, provided that the ***member makes reasonable efforts to obtain the name of and contact information for a trusted contact person.***" Accordingly, a member is required to make ***reasonable efforts*** to obtain the trusted contact name and contact information. However, if the customer declines to provide the information or fails to respond to the member's efforts to obtain the information, the member can open or maintain the customer's account. Asking a customer to provide the name and contact information for a trusted contact (*e.g.*, in an account opening form) ***constitutes reasonable efforts*** to obtain the information and satisfies the Rule 4512 requirements."	tly-asked-questions-regarding-finra-rules-relating-financial-exploitation-seniors
Oct. 29, 2018	"These decisions reflect the principle that, in general, good faith judgments of CCOs made ***after reasonable inquiry and analysis*** should not be second guessed. In addition, ***indicia of good faith or lack of good faith are important***	Opinion of the Commission, *Thaddeus A. North*, Exchange Act Release No. 84500

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	factors in assessing reasonableness, fairness and equity in the application of CCO liability.	https://www.sec.gov/litigation/opinions/2018/34-84500.pdf
May 23, 2019	"The immunity established by the [Senior Safe] Act is provided on the condition that employees receive training on how to identify and report exploitative activity against seniors before making a report. In addition, ***reports of suspected exploitation must be made "in good faith" and "with reasonable care."*** This immunity applies to individuals and firms."	SEC, NASAA, and FINRA Issue Senior Safe Act Fact Sheet to Help promote Greater Reporting of Suspected Senior Financial Exploitation https://www.sec.gov/news/press-release/2019-75
June 5, 2019	"The new rules will enhance the standard of conduct that broker-dealers owe to their customers and align the standard of conduct with ***retail customers' reasonable expectations***."	SEC Open Meeting Fact Sheet Regulation Best Interest https://www.sec.gov/news/press-release/2019-89
June 5, 2019	"A broker-dealer must exercise ***reasonable diligence, care and skill*** when making a recommendation to a retail customer."	Regulation Best Interest Care Obligation https://www.sec.gov/news/press-release/2019-89
June 5, 2019	"The broker-dealer must establish, maintain, and enforce written policies and procedures ***reasonably designed*** to identify and at a minimum disclose or eliminate conflicts of interest."	Regulation Best Interest Conflict of Interest Obligation https://www.sec.gov/news/press-release/2019-89
June 5, 2019	"In an enhancement from the proposal, broker-dealers must establish, maintain and enforce policies and procedures ***reasonably designed to achieve compliance*** with Regulation Best Interest as a whole."	Regulation Best Interest Compliance Obligation https://www.sec.gov/news/press-release/2019-89
March 4, 2020	Advertising Regulation **"Q. Our firm's registered representatives are unable to meet with their customers face-to-face because they are working from home or due to COVID-19 related restrictions, and instead are meeting with clients via a live video or audio conferencing platform. How should our firm supervise these meetings? Is**	Frequently Asked Questions Related to Regulatory Relief Due to the Coronavirus Pandemic https://www.finra.org/rules-guidance/key-topics/covid-19/faq

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	the firm required to keep records of these live video meetings? **A:** Members must supervise registered representatives' live meetings with customers via video or audio conferencing platforms ***in a manner reasonably designed to achieve compliance with applicable securities laws and regulation and FINRA rules***. Unless required to record pursuant to FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms) or otherwise, members generally are not required to record live video or audio conferences with customers. However, if a registered representative during the video or audio conference uses the chat or instant messaging feature of the platform or presents slides or other written (including electronic) communications, the member must keep records of these written communications in accordance with Securities Exchange Act Rule 17a-4 and FINRA Rules 3110.09 (Supervision) and 4511 (General Requirements), and their content must be consistent with applicable standards such as FINRA Rule 2210 (Communications with the Public) and 3110(b) (Supervision). Depending on the nature and number of persons attending the video meeting, these written communications may be correspondence, retail communications or institutional communications, and must be supervised as such. See FINRA Rules 2210(b) and 3110(b)(4). Moreover, if a member chooses to record live video or audio conversations with customers, the member may be required to produce the recording in connection with a regulatory request. If a firm permits public appearances through video or audio conferencing platforms, the member must ensure compliance with FINRA Rule 2210(f). *Added April 16, 2020"*	

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Oct. 20, 2020	"More generally, I am concerned that we appear to assume that every securities violation we find indicates a problem with the firm's compliance program. ***A firm that has reasonably designed policies and procedures nevertheless can experience a securities violation***."	Commissioner Hester M. Peirce, *When the Nail Fails* – Remarks before the National Society of Compliance Professionals https://www.sec.gov/news/speech/peirce-nscp-2020-10-19
Dec. 18, 2020	"However, the Department [of Labor] confirms that, like the Regulation Best Interest requirements, the standard for materiality for purposes of this obligation is consistent with the one the Supreme Court articulated in *Basic* v. *Levinson,* and, in the context of this exemption, ***the standard of materiality is centered on those facts that a reasonable Retirement Investor, as defined in the exemption, would consider important***. Material conflicts of interest that would be required to be disclosed under the exemption would include, for example, conflicts associated with proprietary products, payments from third parties, and compensation arrangements. . . . Several commenters also asked the Department to acknowledge that "prudently" developed policies and procedures are the same as ***"reasonably" developed policies and procedures*****,** or to simply revise the exemption requirement to use the term "***reasonably designed"*** in accord with the text of Regulation Best Interest. These commenters opined that the ***difference between "prudence" and "reasonableness"*** was either unclear or nonexistent. One commenter urged the Department to adopt a definition of commission-based incentives limited to ones where incentives are tied to the sale of specific financial or insurance products within a limited period of time."	Department of Labor, Employee Benefits Security Administration, Prohibited Transaction Exemption 2020-02*, Improving Investment Advice for Workers & Retirees* https://www.federalregister.gov/documents/2020/12/18/2020-27825/prohibited-transaction-exemption-2020-02-improving-investment-advice-for-workers-and-retirees (footnotes omitted)

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Feb. 2021	**Regulation Best Interest (Reg BI) and Form CRS** "We will continue to focus on assessing whether member firms have established and implemented policies, procedures, and a system of supervision ***reasonably designed to comply with Reg BI and Form CRS***. However, in 2021, we intend to expand the scope of our Reg BI and Form CRS reviews and testing to effect a more comprehensive review of firm processes, practices and conduct."	2021 Report on FINRA's Examination and Risk Monitoring Program https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf (p.2)
Feb. 2021	**Variable Annuities** "FINRA Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities) establishes sales practice standards regarding recommended purchases and exchanges of deferred variable annuities, including requiring ***a reasonable belief that the customer has been informed of the various features of annuities*** (such as surrender charges, potential tax penalties, various fees and costs, and market risk); and, prior to recommending the purchase or exchange of a deferred variable annuity, requiring reasonable efforts to determine the customer's age, annual income, investment experience, investment objectives, investment time horizon, existing assets and risk tolerance. To the extent that a broker-dealer or associated person is recommending a purchase or exchange of a deferred variable annuity to a retail customer, Reg BI's obligations, discussed above, also would apply. . . . What do your WSPs require registered representatives to do in order to support a determination that a transaction meets the standard of care requirements and that there is ***a reasonable basis*** for it?" Exam Findings: "Unsuitable Exchanges – ***Not reasonably supervising recommendations of exchanges*** that were inconsistent with the customer's objectives and time horizon and resulted in, among other consequences,	2021 Report on FINRA's Examination and Risk Monitoring Program https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf (pp. 26-27)

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	increased fees to the customer or the loss of material, paid-for accrued benefits."	
Feb. 2021	**Cybersecurity** "The SEC's Regulation S-P Rule 30 requires firms to have written policies and procedures that ***are reasonably designed to safeguard customer records and information***. . . . In addition to firms' compliance with SEC regulations, FINRA reminds firms that cybersecurity remains one of the principal operational risks facing broker-dealers, and ***expects firms to develop reasonably designed cybersecurity programs and controls that are consistent with their risk profile, business model and scale of operations***."	2021 Report on FINRA's Examination and Risk Monitoring Program https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf (p.8)
Feb. 2021	**AML** "FINRA Rule 3310 (Anti-Money Laundering Compliance Program) requires that members develop and implement a written anti-money laundering (AML) program ***reasonably designed to comply with the requirements of the BSA and its implementing regulations***. Additionally, FinCEN's Customer Due Diligence (CDD) rule requires that firms identify beneficial owners of legal entity customers, understand the nature and purpose of customer accounts, and conduct ongoing monitoring of customer accounts to identify and report suspicious transactions and—on a risk basis—update customer information."	2021 Report on FINRA's Examination and Risk Monitoring Program https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf (p. 5)
Feb. 2021	**Digital Communication** Exam Findings: "Insufficient Supervision and Recordkeeping for Digital Communication – ***Not maintaining policies and procedures to reasonably identify and respond to red flags***—such as customer complaints, representatives' email, OBA reviews or advertising reviews—that registered representatives used impermissible business-related digital communications methods, including texting,	2021 Report on FINRA's Examination and Risk Monitoring Program https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf (p. 21)

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	messaging, social media, collaboration apps or "electronic sales seminars" in chatrooms."	
Feb. 2021	**Private Placements** "As noted in Regulatory Notice 10-22 (Obligations of Broker-Dealers ***to Conduct Reasonable Investigations*** in Regulation D Offerings), as part of their obligations under FINRA Rule 2111 (Suitability) and supervisory requirements under FINRA Rule 3110 (Supervision), ***firms must conduct a "reasonable investigation"*** by evaluating "the issuer and its management; the business prospects of the issuer; the assets held by or to be acquired by the issuer; the claims being made; and the intended use of proceeds of the offering." The SEC's Reg BI became effective on June 30, 2020, and would apply to recommendations of private offerings to retail customers. Reg BI similarly requires, among other things, a broker-dealer ***to exercise reasonable diligence, care and skill*** to understand the potential risks, rewards and costs associated with a private offering recommendation and ***have a reasonable basis to believe*** that the private offering recommendation could be in the best interest of at least some retail customers."	2021 Report on FINRA's Examination and Risk Monitoring Program https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf (p. 24)
Feb. 2021	**Best Execution** "FINRA Rule 5310 (Best Execution and Interpositioning) requires that, in any transaction for or with a customer or a customer of another broker-dealer, a member and persons associated with a member ***shall use reasonable diligence to ascertain the best market for the subject security***, and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.	2021 Report on FINRA's Examination and Risk Monitoring Program https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf (p. 31)
March 3, 2021	"The Division will continue to review for compliance with applicable anti-money laundering (AML) requirements, including evaluating whether broker-dealers and	Anti-Money Laundering Programs - SEC Division of Examinations Announces 2021 Examination Priorities

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	registered investment companies have adequate policies and procedures in place that are ***reasonably designed to identify suspicious activity and illegal money-laundering activities***."	https://www.sec.gov/news/press-release/2021-39
March 3, 2021	"The Division will continue to review the compliance programs of registered investment advisers (RIAs), including whether those programs and their policies and procedures are ***reasonably designed, implemented, and maintained***."	Compliance Programs - SEC Division of Examinations Announces 2021 Examination Priorities https://www.sec.gov/news/press-release/2021-39
Undated	"FINRA Rule 2111 requires, in part, that a broker-dealer or associated person 'have ***a reasonable basis to believe*** that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information ***obtained through the reasonable diligence*** of the [firm] or associated person to ascertain the customer's investment profile.'" **"Q3.5. What constitutes *'reasonable diligence'* in attempting to obtain the customer-specific information? [Notice 12-25 (FAQ 16)]** **A3.5.** ***Although the reasonableness of the effort will depend on the facts and circumstances***, asking a customer for the information ordinarily will suffice. Moreover, absent 'red flags' indicating that such information is inaccurate or that the customer is unclear about the information, a broker generally may rely on the customer's responses. A broker may not be able to rely exclusively on a customer's responses in situations such as the following: • the broker poses questions that are confusing or misleading to a degree that the information-gathering process is tainted,	FINRA Rule 2111 FAQs https://www.finra.org/rules-guidance/key-topics/suitability/faq (footnotes omitted)

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	• the customer exhibits clear signs of diminished capacity, or • other 'red flags' exist indicating that the customer information may be inaccurate." Reasonable-Basis Suitability **"Q5.1. Can a broker who does not understand the risks associated with a recommendation violate the *reasonable-basis obligation* even if the recommendation is suitable for *some* investors? [Notice 12-25 (FAQ 22)]** **A5.1.** Yes. ***The reasonable-basis obligation*** has two components: a broker must (1) ***perform reasonable diligence to understand the nature*** of the recommended security or investment strategy involving a security or securities, as well as the potential risks and rewards, and (2) determine whether the recommendation is suitable for at least some investors based on that understanding. ***A broker must adhere to both components of reasonable-basis suitability.*** A broker could violate the obligation if he or she did not understand the recommended security or investment strategy, even if the security or investment strategy is suitable for at least some investors. A broker must understand the securities and investment strategies involving a security or securities that he or she recommends to customers. The ***reasonable-basis obligation*** is critically important because, in recent years, securities and investment strategies that brokers recommend to customers, including retail investors, have become increasingly complex and, in some cases, risky. Brokers cannot fulfill their suitability responsibilities to customers (***including both their reasonable-basis and customer-specific obligations***) when they fail to understand the securities and investment strategies they recommend. Firms' supervisory policies and procedures must be ***reasonably***	

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	designed to ensure that their brokers comply with this important requirement."	
Undated	**"1.2 If a member firm recently becomes aware of a potential violation of the securities laws by the firm or an associated person and is gathering the available facts to determine whether it, or the associated person, violated such laws and whether the violation meets the reporting threshold of FINRA Rule 4530.01 is the firm required to report the matter within 30 calendar days after it first became aware of the potential violation?** No. As noted in Answer 1.1, FINRA Rule 4530(b) states that each member firm shall promptly report to FINRA, but in any event not later than 30 calendar days, after the firm has *concluded* or ***reasonably should have concluded*** that an associated person of the firm or the firm itself has violated any securities-, insurance-, commodities-, financial- or investment- related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or SRO. Further, for purposes of FINRA Rule 4530(b), only those violations that meet the reporting threshold under FINRA Rule 4530.01 are required to be reported. ***FINRA will apply a 'reasonable person' standard*** to determine whether a violation should have been reported. ***If a reasonable person,*** considering the available facts, would have concluded that a violation meeting the reporting thresholds occurred, then the matter would be reportable. ***If a reasonable person***, considering the available facts, would not have concluded that a violation occurred or would have been unable to conclude whether a violation occurred, then the matter would not be reportable.	Rule 4530 Frequently Asked Questions https://www.finra.org/filing-reporting/regulatory-filing-systems/rule-4530-reporting-requirements/faq

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	In the example above, because the firm is still in the process of gathering the available facts, it is not in a position to conclude, or ***reasonably conclude***, whether a reportable violation occurred. In this regard, it should be noted that a firm cannot intentionally or negligently delay the fact-finding stage and must make reports at the ***earliest reasonable date.*** *See also* FAQ 1.5: 'FINRA recognizes that a member firm may take remedial steps with respect to its associated persons where the firm ***nevertheless reasonably does not determine a violation has occurred.*** It is also the case that a member firm's determination not to take remedial action in respect of certain conduct is ***not by itself a basis for asserting a reasonable conclusion*** that a violation has not occurred, and, ***where a reasonable person would have determined*** that a violation has occurred, the firm would potentially be in violation of both FINRA Rule 4530(b) and the firm's duty to ***reasonably supervise*** its associated persons.'"	