



NASAA

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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June 29, 2017

Submitted electronically to pubcom@finra.org.

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

RE: Regulatory Notice 17-20 – Retrospective Rule Review, Outside Business Activities and Private Securities Transactions

Dear Ms. Mitchell:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),¹ I hereby submit the following comments in response to Regulatory Notice 17-20 requesting feedback on the effectiveness of FINRA rules regarding outside business activities and private securities transactions (the “Regulatory Notice”).²

Fraud and other forms of misconduct arising from outside business activities and private securities transactions by associated persons of broker-dealers is a perennial problem. NASAA’s members have been battling this for years, as have FINRA and its forebears.³ This bedeviling subject is a problem for regulators, investors and for the brokerage industry.

Most problems in this area can be traced to undisclosed, and therefore unknown, outside business or sales activities. Broker-dealers generally do a good job monitoring those outside activities of which they are aware. But even the best-managed firms with the most comprehensive compliance programs have difficulty policing outside activities if employees and other associated persons purposefully hide these activities. Because broker-dealers are the first line of defense for investors, we believe it is appropriate for FINRA’s Sanction Guidelines to be

¹ Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

² Regulatory Notice 17-20, Retrospective Rule Review – *FINRA Requests Comment on the Effectiveness and Efficiency of Its Rules on Outside Business Activities and Private Securities Transactions* (May 2017), available at <http://www.finra.org/industry/notices/17-20>.

³ See, e.g., NASD Notice to Members 01-79, *Selling Away and Outside Business Activities* (Dec. 2001).

amended to provide greater deterrence and remedies through more punitive sanctions for nondisclosure of outside activities. Based on the frequency of failures to disclose outside activities and the consequent damage that results from broker-dealers' inability to monitor such unknown activities, the current Sanction Guidelines have proven to be too lenient and an insufficient incentive to impel associated persons to disclose all of their outside activities to their employers.

Under the Sanction Guidelines, failing to notify an employer of a person's outside activities is treated as only one of several factors for adjudicators to consider when assessing sanctions under Rules 3270 and 3280. The Guidelines state that "[w]hether the respondent misled his or her employer" is one of *six* factors to consider under Rule 3270, and one of *thirteen* factors to weigh under Rule 3280.⁴ Nondisclosure to an employer of outside activities, which often is accompanied by affirmative misrepresentations about those activities, should not continue to be downplayed in the Guidelines by not distinguishing this factor from other, less critical factors. Rather, nondisclosure should be treated as a significant rule violation in and of itself, with its own clearly defined consequences.

Accordingly, we strongly encourage FINRA to revise the Sanction Guidelines to segregate Rule 3270 and Rule 3280 violations into those involving disclosed activities and those involving undisclosed activities, and then to implement higher disciplinary guidelines across the board for violations related to undisclosed activities. An associated person's knowing failure to notify an employer of the person's outside activities in violation of Rule 3270 or Rule 3280 should merit more significant fines and/or suspensions than contemplated by the current Sanction Guidelines. Increasing penalties for nondisclosure of outside activities will not be a cure-all, but it would focus attention on the most intractable part of this ongoing problem. Given that existing sanction standards have been ineffective, FINRA should move towards overdeterrence on this issue.

NASAA welcomes an opportunity to discuss this issue further. If you have any questions about these comments, please contact NASAA's General Counsel, A. Valerie Mirko, at vm@nasaa.org or (202) 737-0900.

Sincerely,



Mike Rothman
NASAA President
Minnesota Commissioner of Commerce

⁴ See FINRA Sanction Guidelines, April 2017, pp. 13-15.