Outside Business Activities

A White Paper from the Financial Services Institute, Inc.

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FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

The **Financial Services Institute, Inc. (FSI)** is the advocacy organization for independent broker-dealers (IBDs) and independent financial advisors. The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors who account for approximately 64.5% producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of their associated independent broker-dealers. FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain and those supported in the broader economy.

In addition, FSI members contribute nearly $6.8 billion annually to federal, state and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity. FSI's mission is to create a healthier regulatory environment for independent broker-dealers and their affiliated independent financial advisors through aggressive and effective advocacy, education and public awareness. FSI's advocacy efforts on behalf of our members include industry surveys, research and outreach to legislators, regulators and policymakers. FSI also provides our members with an appropriate forum to share benchmarks in an attempt to improve their compliance, operations and marketing efforts.

We commend and appreciate the hard work, strong efforts and significant time committed to drafting this white paper by the members of FSI's Outside Business Activity Task Force. The Task Force includes:

- Nancy Lininger, Founder/Consultant, The Consortium (Task Force Chair)
- Colleen Bell, First Vice President, Fiduciary Services, Cambridge Investment Research
- Bryan Jacobsen, Chief Compliance Officer, Cetera Advisor Networks
- Ami Shah, Chief Compliance Officer, Consumer Distribution, AIG
- Timothy P. Stone, Senior Vice President and Head of Operations, Cetera Advisor Networks
- Paul Tolley, Senior Vice President and Chief Compliance Officer, Commonwealth Financial Network
- Sandra Whited, 1st Vice President, Compliance Director, INVEST Financial Corporation

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- Brian Rubin, Partner, Eversheds Sutherland LLP
- Amy Xu, Associate, Eversheds Sutherland LLP

Should you have any questions, or would like more information, please contact David Bellaire, FSI's Executive Vice President & General Counsel, at (888) 373-1840.

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I. Introduction

As securities markets and broker-dealers evolve to meet the needs of their clients, so do the compliance programs designed to protect clients and identify risk. One area where there has been recent innovation and development is outside business activities (OBAs). Both regulators and broker-dealer compliance officers have demonstrated a concentrated focus on OBAs, which are common among independent financial advisors.

The IBD channel enables financial advisors to provide services to Main Street Americans, particularly in less populous or affluent communities.[1] According to the Oxford Economics Study on the Economic Impact of FSI Members, FSI members have a more substantial impact in smaller states.[2] As a result, FSI members are found operating on main streets in small and mid-sized towns throughout the U.S. Often these advisors are the only financial experts in their community. Because of the unique relationship between independent advisors and their clients, many clients request and expect to be able to turn to their financial advisor for additional services such as insurance, accounting or other financial-related expertise that are outside the scope of the financial advisor's securities license. OBAs provide clients with the convenience of receiving related services from one professional whom they trust and who also has sophisticated knowledge of their entire financial situation. Regulators have expressed concerns about OBAs, including broker-dealer decision-making concerning the approval of OBAs and firm efforts to monitor their advisors' activities in furtherance of the firm-approved OBA.

The FSI Outside Business Activity Task Force was formed to review OBAs in the IBD channel. In composing this white paper, the OBA Task Force focused on the following questions:

- What benefits do OBAs provide?
- What constitutes an outside business activity?
- What is the regulatory and compliance framework for OBAs?
- What are the consequences for failing to comply with OBA regulatory requirements?
- What practices have firms adopted with regard to OBAs?

II. What are the benefits of OBAs?

A. Why do financial advisors engage in OBAs?

Simply put, financial advisors engage in OBAs because it is often what their clients expect and need. This is particularly true for financial advisors who operate in sparsely populated or rural areas where a variety of professional services are not available to clients. Instead, clients need to work with a professional who can provide them everything they need in one stop. Additionally, independent financial advisors are small business owners. The ability for these advisors to operate

[1] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

[2] See Oxford Economics Study on the Economic Impact of FSI Members, available at **http://www.financialservices.org/uploaded-Files/FSI_Content/Newsroom/Publications/Research/FSI-Impact-Report-Final.pdf**.

their business, pay their staff, and continue to provide crucial retirement and investment advice to their clients is made possible by their ability to offer services outside their securities offerings. These services enable independent financial advisors to hire and maintain their staff from the local community.

FSI members in particular benefit from being able to maintain a strong presence in their communities. According to the 2016 Oxford Economics Study of the Economic Impact of FSI members, FSI members support more than 482,000 jobs.[3] These firms directly support the employment of more than 160,000 financial advisors and support staff. In addition, for each independent financial advisor directly affiliated with an FSI member firm, a further two jobs are supported in the wider economy, either in the supply chains of FSI members or through the wage spending of those employed in the firms themselves or in their supply chains (in total 322,000 additional jobs in industries as diverse as professional services, restaurants and hospitality).[4] By engaging in OBAs, FSI members have enough financial flexibility to support their staff and local community.

B. How do OBAs benefit clients and the community?

Independent financial advisors engage in various OBAs because these services are often not widely available to their clients. As we said in a recent comment letter to FINRA, "Clients of independent financial advisors are typically 'main street Americans' who have tens and hundreds of thousands as opposed to millions of dollars to invest. Often, these financial advisors are the only provider of financial services and planning in their community."[5]

Independent financial advisors share a unique relationship with their clients. Financial advisors, who may also be Certified Public Accountants or insurance agents, have the best understanding of their clients' overall financial situation. They have knowledge about their clients' holistic financial profiles, allowing the financial advisor to understand the specific needs of each client. The ability to provide holistic advice benefits clients by ensuring their financial plan is designed to achieve their goals. Knowing that the financial advisor's recommendations are based on a thorough understanding of their current financial status provides the client additional confidence and comfort. Independent financial advisors are therefore in the best position to advise their clients, for example, on the tax implications of financial decisions or suitable insurance options to meet their needs.

Often, these additional, crucial services are only available as OBAs from independent financial advisors. This is particularly true in rural or sparsely populated areas where insurance or accounting firms are not located. Independent financial advisors are uniquely situated to fill this gap because they are spread throughout the country where larger firms often do not conduct

[3] See Oxford Economics Study on the Economic Impact of FSI Members, available at **http://www.financialservices.org/uploadedFiles/FSI_Content/Newsroom/Publications/Research/FSI-Impact-Report-Final.pdf**.

[4] Id.

[5] Comment Letter on File Number SR–FINRA–2009–042 – Amendment No 1 to Proposed FINRA Rule 3270 (Outside Business Activities of Registered Persons), Financial Services Institute, available at **https://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/Past_Issues/FINRA/FINRA_ListSummary/FSI%20Comment%20Letter%20-%20Outside%20Business%20Activities%20of%20Registered%20Persons%20(FINAL).pdf**.

business.

OBAs are often essential to service the needs of clients in rural and sparsely populated communities who don't have the luxury of choosing from a multitude of qualified professionals. But clients in urban and suburban communities benefit from OBAs as well. Modern clients expect efficiency in both service and cost, and OBAs fulfill this need by allowing a client multiple services from one individual. Clients can work with and receive services from the individual they trust and prefer to work with.

Additionally, the local community benefits from a financial advisor's involvement in OBAs as well. The community benefits from tax revenues and jobs created by these small businesses. Advisors can even leverage their specialized financial expertise and OBAs to better serve local nonprofits and businesses by participating effectively on local nonprofit boards or by sharing their knowledge of the financial and other needs of the community. OBAs thus allow advisors to serve a vital role in their community and better serve its residents.

C. Potential Drawbacks of OBAs

While there are many benefits to OBAs, Section V of this paper outlines various FINRA and state enforcement actions that demonstrate there can also be several drawbacks if financial advisors fail to report an OBA or if firms do not thoughtfully consider whether to approve an OBA and/or fail to adequately monitor approved OBAs. As outlined in Section V, a frequent issue with OBAs involves advisors using their OBA to engage in selling away. Another common issue is investor confusion – investors often do not understand that they are dealing with the financial advisor outside of their relationship with the firm. Investors might assume the business they conduct through the OBA contains the same obligations and protections they enjoy with business conducted through the firm.

III. What constitutes an outside business activity (OBA)?

FINRA Rule 3270 states that "[n]o registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be compensated, or have the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member, in such form as specified by the member."[6]

OBAs include many non-securities business activities which are conducted outside the scope of the relationship a financial advisor has with their broker-dealer firm. These activities can include fixed insurance sales, operating a registered investment adviser or providing additional services such as tax preparation, accounting support, bookkeeping or legal advice. An activity does not need to result in compensation to qualify as an OBA. OBAs can include non-compensated leadership positions a financial advisor holds such as being a president, treasurer, trustee or other position of a non-profit board of trustees. Firms decide, on an individual basis, which activities will be

[6] FINRA Rule 3270, available at **http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9467**.

approved, approved with limitations or restrictions, or denied.

Identifying activities that meet with definition of OBA is the first step toward compliance. It is important that financial advisors, as well as IBD personnel, understand this definition and its implications. We discuss those implications in greater detail below.

IV. What is the regulatory and compliance framework for OBAs?

A. What are the FINRA rules that govern OBAs?

FINRA Rule 3270 (Formerly NASD Rule 3030) - Outside Business Activities of Registered Persons

FINRA Rule 3270, which replaced NASD Rule 3030 in 2010, restricts a financial advisor's ability to engage in OBAs. While FINRA Rule 3270 does not require a firm to provide its approval or disapproval of the OBA, the majority of IBD firms have written supervisory procedures that require the financial advisor to inform them of the OBA and cease to undertake it until the firm approves or disapproves of the activity. Therefore, as a practical matter, once an IBD firm is informed of an OBA, they must determine if the activity is either:

- A permitted activity per the firm's written supervisory procedures,
- An activity approved by the firm per their written supervisory procedures, but subject to specific conditions, or
- An activity not permissible per the firm's written supervisory procedures resulting in the financial advisor barred by the firm from engaging in it under any circumstances.

In supplementary materials to Rule 3270, FINRA provided three key factors firms must take into consideration when evaluating whether to approve, impose specific conditions or deny the OBA request altogether. FINRA requires a firm to consider whether an OBA will:

- Interfere with or otherwise compromise the registered person's responsibilities to the member and/or the member's clients,
- Be viewed by the client or the public as part of the member's business based upon, among other factors, the nature of the proposed activity and the manner in which it will be offered,[7] or
- Be characterized as an outside business activity or whether it should be treated as an outside securities activity [for example a Private Securities Transaction (PST)].[8]

Firms should be mindful of these key considerations when they review proposed OBAs because once the activity is deemed permissible, the firm must provide ongoing monitoring of the OBA for compliance with any limitations. It may be helpful for firms to evaluate these activities from the perspective of the client. Firms should ask themselves if the client could perceive the activity as

[7] Id at 1.
[8] Id.

being associated with the firm and, if the answer is "Yes," consider imposing restrictions or denying the request to engage in the OBA.

FINRA has released considerable additional guidance to provide further clarity around the rule. For example, in Notice to Members 01-79, which dealt primarily with promissory notes, FINRA reminded financial advisors of their responsibility to report such activities to their firms.[9] to The notice reminded firms they should "review their supervisory and compliance procedures to make sure that their reporting requirements are clear and complete and that each associated person receives appropriate education and training regarding the sale of notes." You will find a complete reference list of FINRA's OBA-related guidance in Appendix II.

While FINRA Rule 3270 creates the general regulatory framework that governs OBAs, FINRA Rule 3110 requires firms to adopt written supervisory procedures (WSPs) that are reasonably designed to ensure compliance with FINRA rules.[10] Therefore, with regard to Rule 3270, members include in their WSPs the process, procedures, and standards under which they will evaluate proposed OBAs. It is also common and advisable for firms to include in their WSPs their process for evaluating whether the activity is an OBA or a PST. Firms must adequately outline their approval process, documentation, and monitoring of OBAs. Firms should also document and preserve their decision making process and any additional monitoring they conduct. For example, a firm's WSPs could require that it maintain and preserve:

- A written summary of the activities to be performed by the financial advisor;
- A written request from the financial advisor to engage in the outside business activity; and
- A written response from the firm acknowledging the request and approving, limiting or denying the advisor's involvement with that activity.

FINRA has provided sanction guidelines that detail the principal considerations used to determine appropriate consequences. Failure to comply with FINRA Rule 3270 can result in monetary sanctions of $2,500 to $73,000.[11] The severity of the fine is based on a review of the following:

- Whether the outside activity involved clients of the firm.
- Whether the outside activity resulted directly or indirectly in injury to clients of the firm and, if so, the nature and extent of the injury.
- The duration of the outside activity, the number of clients and the dollar volume of sales.
- Whether the respondent's marketing and sale of the product or service could have created the impression that the firm had approved the product or service.
- Whether the respondent misled his or her firm about the existence of the outside activity or otherwise concealed the activity from the firm
- The importance of the role played by the respondent in the OBA.[12]

[9] Notice to Members 01-79, available at **https://www.finra.org/industry/notices/01-79**.
[10] FINRA Regulatory Notice, available at **https://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p038506.pdf**.
[11] FINRA Sanction Guidelines, available at **http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf**.
[12] Id.

Suspension, bar and additional sanctions can also occur. FINRA's Sanction Guidelines also state:

- FINRA will consider suspending the respondent in any or all capacities for a period of 10 business days to three months.
- When the outside business activities involve aggravating conduct, [FINRA will] consider a longer suspension of up to one year.
- Where aggravating factors predominate, FINRA will consider a longer suspension of up to two years or a bar.[13]

B. What other things should firms consider when reviewing OBA requests?

There are some important additional concerns and considerations that firms should take into account during their decision making process regarding their OBA approval process. FINRA's annual conferences regularly include panels on the subject of OBAs and PSTs that provide helpful insight into the ways firms are interpreting the rule and their suggested best practices. Helpful information provided by industry panelists over the past couple of years suggests that firms would benefit from asking the following questions when reviewing OBAs:

- Will the OBA confuse the client?
- Will the OBA be confused with the broker-dealer business?
- Is the OBA actually a PST?
- Where will the OBA take place?
- Will the OBA be covered under the firm's E&O insurance?
- How often will the firm review this activity? What sort of due diligence will the firm have to take in order to monitor potential changes in the activity?
- Even if the role is an unpaid volunteer role, are the facts and circumstances such that the firm should be concerned about the activity?
- Even if there is no compensation, does the expectation of compensation exist or might it exist in the future?
- Does the role, whether paid or unpaid, involve access to funds (for example, a treasurer role)?
- How might the OBA change over time? For instance, could it evolve into a paying position, could it begin to require a larger time commitment, is there a possibility of PSTs going through the OBA, etc?
- Could the OBA be confused as being offered through the firm?[14]

Industry panelists have also provided the helpful suggestions for firms to consider incorporating into their training and WSPs to ensure that they are properly identifying potential red flags and are on the lookout for additional undisclosed activities:

- Firms should not allow advisors to be mortgage brokers and sell reverse mortgages.

[13] Id.

[14] Statements made during FINRA's conferences, whether made by FINRA staff or by non-FINRA panelists are not and should not be considered formal FINRA guidance from FINRA. Instead, these points are offered as examples of actions taken by non-FINRA panelists to address OBAs and PSTs and should not be considered a position adopted or endorsed by FINRA.

- If an advisor is setting up an LLC or other partnership or corporation, the firm should investigate whether the other named principals are clients.
- Firms should notice any lifestyle changes that do not fall in line with the advisor's earnings and investigate those changes by reviewing the advisor's tax records.
- If a firm sees money coming to an advisor that is not related to the broker-dealer business the firm should inquire about it.
- If the activity does not relate to the broker-dealer business and takes up a substantial portion of the advisor's time, it should not be approved.
- Firms should use their secretary of state's website to see advisor's involvement with other companies.
- Firms should occasionally look at Zillow to see the value of an advisor's home to ensure they are living within their means.
- Firms should review a financial advisor's third party emails that come through the firm's server.
- Firms should periodically re-evaluate approved and denied activities.
- Advisors must alert firms about the sale of their outside businesses. Depending upon relevant facts and circumstances, such sales of a business may constitute a PST. The firm should investigate the sale and conduct proper due diligence.
- A firm's WSPs may also require OBA approvals to include express conditions that address any future documentation that will be required to demonstrate compliance with any limitations put in place.
- A firm's WSPs may also address the time period in which the firm will review OBA requests. Although this is not an express requirement imposed by FINRA Rule 3270, they strongly encourage firms to institute an internal minimum notice period.

While these considerations are not found in the rule itself, they are a helpful guide to FINRA's expectations of firms.

C. Do OBAs need to be supervised by firms?

Although FINRA Rule 3270 does not impose any specific supervisory requirements, firms that permit OBAs have a responsibility to appropriately and reasonably monitor those activities based on the level of risk associated with the activity. A FINRA executive has stated "[w]hile FINRA recognizes that a member does not have the same supervisory responsibilities over a registered person's outside non-securities activities as it does for his or her outside securities activities, a member nevertheless has an important regulatory responsibility to evaluate the potential impact of the outside business activities of its registered persons, and FINRA Rule emphasizes that responsibility."[15] As a result, firms must respond appropriately to "red flags" that may indicate a failure to report an OBA accurately. In addition, if a firm denies a financial advisor's request to participate in an OBA, the firm must take reasonable steps to ensure that the financial advisor is not engaging in the prohibited activity. Also, if a firm approves a financial advisor's participation in an OBA but places restrictions or limitations on the activity or involvement, the firm must monitor that the financial advisor adheres to those limitations and follow up on any red flags that could

[15] FINRA outside business activities rule effective December 15, JORDEN BURT LLP, Nov. 8, 2010, available at **http://www.lexology.com/library/detail.aspx?g=fa508127-02f5-49fe-b5b0-40e970107cbb**. (November 8, 2010).

indicate a failure to comply. This may be accomplished during a yearly branch office examination but can also be monitored in various other ways, such as review of correspondence, conversations with colleagues and simple observation by supervisory personnel.

V. What are the consequences for failing to comply with OBA regulatory requirements?

A. FINRA Enforcement

1. Incorrectly treating conduct as n OBA instead of a private securities transaction

There is an important distinction between OBAs and PSTs. OBAs involve a non-securities business activity outside the role an advisor has with their firm. PSTs are "any securities transaction outside the regular course or scope of an associated person's employment with a member."[16] PSTs are governed by FINRA Rule 3280, which applies to all associated persons of a member firm including both registered and non-registered persons. It is important for a firm to properly distinguish activities between the two due to the different oversight and monitoring requirements that FINRA has imposed on each. Additionally, while firms are required to approve or disapprove PSTs, no such requirement is contained in the OBA rule. Instead, firms have widely adopted the approval or disapproval process as part of their WSPs to ensure they properly examine the request and weigh the facts and circumstances thoroughly and consistently.

2. Failure to supervise for compliance with FINRA Rule 3280

FINRA has sanctioned firms for treating PSTs as an OBA.[17] For example, one firm conducted an examination of the office of one of its financial advisors and discovered that the representative was recommending "managed accounts" and "alternative investments" through his outside registered investment advisor (RIA), even though he had never disclosed this business to his firm. Later in the year, the same financial advisor disclosed to his firm that he was managing an investment fund as an OBA. The firm failed to adequately investigate these red flags, therefore failing to identify his participation in PSTs requiring compliance with Rule 3280. The firm also failed to identify the failure to supervise the PSTs of 79 additional financial advisors registered with the firm because the firm treated their representatives' trading activities as OBAs rather than as PSTs. Thus, the firm failed to establish and maintain a reasonable supervisory system. FINRA fined the firm $500,000 for this and other violations.

In another case, a financial advisor disclosed to his firm that, as an OBA, he generated leads and acted as an "Client Relations Liaison" for an exploration and production company focused on the acquisition, development and marketing of natural gas.[18] He also joined the CEO of that company at conferences to develop qualified leads, making presentations about market trends for natural gas and oil, tax strategies for ownership of oil and gas, and the strategies that the

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[16] FINRA Rule 3280, available at **http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=12012**.
[17] AWC #2011025618702 (June 25, 2015).
[18] AWC No. 2013035830101 (March 3, 2015).

exploration and production company used to explore fossil fuels. For that work, he received both a salary and a bonus for each qualified lead he provided. His firm failed to evaluate whether his activities constituted PSTs. The firm also violated Rule 3270 because it failed to maintain a record of its determination of whether his activities were properly reported as an OBA or whether they should be treated as private securities activities subject to FINRA Rule 3280. FINRA fined the firm $8,500.[19]

3. Failure to properly investigate red flags indicating a likely PST or fraud

FINRA has sanctioned firms for failing to properly investigate red flags regarding OBAs. For example, FINRA sanctioned a firm and the CCO for failing to follow up regarding a red flag resulting from an OBA disclosure. A financial advisor had disclosed an OBA as being formed for the purpose of "raising capital for investment in closely held businesses." The advisor stated that he served as a "managing member coordinating structure and bringing investors." FINRA stated that an OBA disclosure of that nature should have raised "heightened scrutiny" to determine if the activity involved PSTs subject to FINRA Rule 3280. The CCO, however, failed to conduct any review and permitted the representative's involvement with the entity as an OBA. FINRA fined the firm $70,000 for this and other violations, suspended the CCO from acting in a principal capacity for six months and fined him personally $5,000.[20]

FINRA has also sanctioned firms for failing to inquire into outside activities, despite receiving red flags regarding a possible fraudulent scheme. In one such example, the firm learned of allegations on a website that an outside business of two of its representatives was a Ponzi scheme, yet failed to investigate whether the claims had merit. As a result, two financial advisors at the firm raised more than $4 million from investors, many of whom were firm clients. FINRA fined the firm $100,000 for its failure to supervise the outside business activities of the two financial advisors, among other violations.[21]

4. Failure to disclose OBAs on Forms U4

FINRA has sanctioned firms for failing to ensure their registered persons updated their Form U4 to reflect OBAs. One firm failed to file Form U4 amendments after its representatives had properly disclosed their OBAs. The firm also failed to file Form U4 amendments for more than 4 months after FINRA had advised the firm of its deficiencies in timely filing U4 amendments to reflect disclosed OBAs. In addition, while the firm encouraged advisors to disclose OBAs to the firm, it failed to properly scrutinize the disclosures to ensure that all OBAs were being properly disclosed and accurately reflected on Form U4 updates. As a result of this and other conduct, FINRA fined the firm $500,000.[22]

Another firm failed to amend Forms U4 for its financial advisors, despite having approved the OBAs.[23] The firm disclosed the OBAs on the Forms U4 only after receiving notification from FINRA

[19] Id.
[20] AWC # 2012030734501 (June 10, 2015).
[21] FINRA NAC Decision, Complaint No. 2009017195204 (April 29, 2015).
[22] AWC #2011025618702 (June 25, 2015).
[23] AWC #2013035059001 (June 25, 2015).

staff during an examination. For this violation and others, FINRA fined the firm $125,000.

These enforcement actions show the importance of firms properly monitoring all disclosed OBAs and ensuring they are reflected quickly and accurately on the advisors' Form U4. Additionally, the rationale for the enforcement actions demonstrates the necessity of firms to investigate that their financial advisors are being honest with their forms and are following the firms' monitoring direction.

5. Failure to enforce WSPs

FINRA has sanctioned firms for failing to follow their own WSPs. For example, a firm's WSPs required all supervising principals to "poll all the individuals under their direct supervision to determine if any amendments [were] required on their U4 to either report a new disclosure event or to change the status of a currently disclosed event" on a monthly basis.[24] The firm, by and through its CEO/CCO, failed to poll its financial advisors in accordance with the firm's procedures. As a result, approximately 50 out of 60 financial advisors had Forms U4 that did not list all outside business activities. For this conduct and for other violations, FINRA fined the firm $200,000. The CEO/CCO was suspended from acting in a principal capacity for two years and fined personally $25,000.

Similarly, FINRA has sanctioned firms for failing to adhere to existing WSPs regarding reviewing and approving OBAs, even when those WSPs were not current with FINRA Rule 3270. For example, one firm had outdated WSPs in place which required the CCO to ensure that an OBA form, documenting the nature of the outside activity, be completed, signed and returned to each financial advisor.[25] At the time of the examination, 14 representatives failed to complete the OBA form. For this violation and others, FINRA fined the firm $125,000. The president was fined personally $10,000 and suspended for two months from associating with a member firm in a principal capacity.

6. Failure to have written supervisory procedures (WSPs) addressing FINRA Rule 3270

FINRA has sanctioned firms for failing to have written supervisory procedures addressing FINRA Rule 3270.[26] FINRA found that one firm, by and through the firm's CEO/CCO, failed to monitor and scrutinize representatives' outside business activities because the firm did not revise the firm's policies to make them consistent with the revised rule.[27] Moreover, while the firm was notified of proposals to engage in certain OBAs, the firm failed to review them to determine whether they interfered with the representatives' responsibilities to the firm's clients and whether the activities would be viewed by clients as part of the firm's business. For this conduct and for other violations, FINRA fined the firm $200,000, while suspending the CEO/CCO from acting in any principal capacity for two years and fining him $25,000.

[24] AWC #2012030718001(November 11, 2013).
[25] AWC #2013035059001 (June 25, 2015).
[26] FINRA Rule 3270 became effective December 15, 2010.
[27] Letter of Acceptance, Waiver and Consent (AWC) #2012030718001(November 11, 2013).

Similarly, FINRA sanctioned another firm and its president (who was also the CCO for part of the relevant time) for failing to update the firm's WSPs to address Rule 3270.[28] For these and other violations, FINRA fined the firm $125,000, fined the president $10,000 and suspended him from associating with a member firm in a principal capacity for two months.

B. State Regulatory Perspective

State securities departments or divisions generally have the independent authority to investigate and, where violations of state law have occurred, issue temporary or permanent cease and desist orders, suspensions or monetary sanctions against individuals, broker-dealers, investment advisers, or others. In addition to being the subject of potential SEC or FINRA actions, state regulators have independent authority to sanction firms. As a result, OBA's are a large part of state enforcement activities. While state regulators are consistent with their concerns and issues regarding OBAs, each state has their own unique expectations and technical requirements. Firms should be familiar with each individual state regulators' expectations and requirements.

Furthermore, since a major component of the independent business model is the financial advisor having their own business entity and the entity has its own "doing business as" (DBA) name, firms and financial advisors should also be aware that states vary widely in their business registration requirements. Some states require registration with the Secretary of State whereas others may register businesses through their Department of Revenue. If a DBA is not properly registered as a business entity, investors seeking to determine if the business is legitimate and appropriately registered with the state and FINRA may erroneously determine the DBA is illegitimate. To the extent firms can assist financial advisors in determining the appropriate procedure to register their DBA with the state, this will benefit firms, advisors, and investors. Firms should be familiar with each state's particular requirements

1. State Regulatory Enforcement

From the state securities regulators' perspectives, a lot of the regulatory concerns regarding OBAs stem from a lack of proper follow-up and monitoring by firms to ensure that the activity has been accurately disclosed and approved by the firm. State securities regulators expect firms to review their internal procedures regarding OBAs and, if necessary, take appropriate actions to strengthen them. Below are summaries of state enforcement actions that demonstrate areas where firms could strengthen their WSPs to prevent such situations.

2. Failure to disclose OBAs on Forms U4

In 2015, the Florida Division of Securities entered a final order against both a firm and a financial advisor for failing to maintain current books and records, provide timely updates to their Form U4s and properly disclose OBAs. The firm was fined $10,000 in administrative fines.[29]

[28] AWC #2013035059001 (June 25, 2015).
[29] Quarterly Agency Achievement Report, Florida Office of Financial Regulation, July-Sept. 2015, available at **http://www.flofr.com/StaticPages/documents/OFRQuarterlyReport92015.pdf.**

In May of 2014, the New Mexico Securities Division found during an examination that multiple representatives at a firm were not disclosing their OBAs. They also did not disclose personal bankruptcies. As a response to this determination, the firm updated all Form U4s and no further action was required.[30]

3. Failure to enforce WSPs

In July 2008, the Texas Securities Division entered a final order against a firm for the firm's failure to ensure their outside activity request forms were completed by their advisors and failure to request further information about these activities. In this case, a financial advisor created a hedge fund that was registered with the state of Illinois. The financial advisor disclosed his involvement with the hedge fund on his outside activities form. The firm failed to properly review the form and conduct a reasonable review that the financial advisor's conduct complied with the firm's WSPs. As a result of the firm's failure to review, the advisor took $5.5 million in connection with his hedge fund from his clients. The firm was required to pay an administrative fee of $400,000 to the Commission.[31]

In September 2013, the Florida Division of Securities entered a stipulation and consent order with a firm for failure to enforce the firm's established procedures and supervisory system to prevent and detect a fraudulent scheme. A financial advisor, while at the firm, orchestrated a scheme that defrauded clients out of more than $4 million. The firm had a supervisory program where the firm would provide unannounced inspections with follow up internal citations regarding the advisor's shortcomings. However, the firm did not follow their own supervisory program and failed to detect the advisor's OBA website. The firm provided the Division with evidence of improvements to their supervisory policies and procedures and was required to pay an administrative fine of $35,000, and a reimbursement fee of $15,000.[32]

4. Failure to properly investigate red flags indicating a likely fraud

In January 2016, the Florida Division of Securities learned from a FINRA investigation into a firm's Form U5 termination of an advisor that the advisor was engaging in outside business activities. The firm received a complaint from a client about their financial advisor. When the firm looked into the complaint, they discovered that the advisor had advised the client to invest in private securities, some of which were owned by the advisor. The advisor never disclosed these activities to the firm on the firm's outside activity approval request form. Instead the advisor annually attested that they did not engage in any outside activities. The Florida Division of Securities entered a final order barring an advisor from the industry and requiring her to pay an administrative fine of $27,500.[33]

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[30] Recent Violations, New Mexico Regulation & Licensing Department, available at **http://www.rld.state.nm.us/securities-division/recent-examination-violations-3.aspx**.
[31] Administrative Action IC08-CAF-07, July 21, 2008, available at **https://www.ssb.texas.gov/news-publications/order-no-ic08-caf-07**.
[32] Florida OFR Administrative Proceeding No 0662-S-8/12, Sept. 3, 2013.
[33] Florida OFR Administrative Action 51504-S, Jan. 29, 2016.

5. Failure to properly investigate red flags

In March of 2014, the Washington Department of Financial Institutions Securities Division found a financial advisor, while conducting securities business through his affiliated firm, also operated an insurance business and partnered with a credit union to provide loans to his clients. The advisor engaged in activities prohibited by the firm, such as not disclosing loans a client made to his immediate family members, arranging loans for and between clients and entering into a personal financial transaction with a client. The financial advisor also did not provide prompt written notice to his firm when he received compensation from an OBA and made material misstatements on annual compliance questionnaires that he submitted regarding his outside compensation. The financial advisor's registration was revoked and future registration will be denied. He was also fined $25,000.[34]

In July of 2014, the Enforcement Section of the Missouri Securities Division of the Office of Secretary of State determined that a firm failed to reasonably supervise one of its financial advisors who had engaged in dishonest and unethical practices. The financial advisor offered and sold investments in a fraudulent investment scheme and misappropriated funds from at least eight clients, of which six were clients of the firm. The advisor deposited the funds from these sales into his personal bank account and used the money for personal expenses. The financial advisor was barred from the industry. The firm failed to detect the financial advisor's behavior. The firm agreed to pay $630,000 in restitution to the six firm clients. The firm also paid $1 million to the Missouri Secretary of State's Client Education and Protection Fund and $10,000 for the cost of the investigation.[35]

In June of 2014, the Enforcement Section of the Missouri Securities Division of the Office of the Secretary of State determined that a firm failed to reasonably supervise one of its financial advisors who had engaged in dishonest and unethical practices. The financial advisor pled guilty to participating in a scheme that defrauded 22 of the firm's clients. The advisor also used his firm's approved email to send out multiple statements regarding undisclosed OBAs to other clients of the firm. The firm failed to review or approve these OBAs or the emails. The firm ultimately settled with the Division, paying $1.9 million to the clients who were defrauded and $170,000 to cover the cost of the investigation.[36]

In September of 2015, the New Jersey Bureau of Securities found that a financial advisor had engaged in undisclosed OBAs. The financial advisor was involved with a nightclub that was also owned by several of his clients. The advisor helped facilitate loans between clients and took part in undisclosed PSTs by recommending his clients invest in a startup managed by a friend. None of these activities were approved by the firm. The firm had a policy that did not permit financial advisors to participate in PSTs. These OBAs were in direct violation of the firm policy. The individual was barred from the industry.[37]

[34] Order Number S-11-0596-14-FO01, Mar. 2014, available at **http://www.dfi.wa.gov/documents/securities-orders/S-11-0596-14-FO01.pdf**.

[35] Case No. AP-14-12, July 2014, available at **http://www.sos.mo.gov/cmsimages/securities/orders/AP-14-12.pdf**.

[36] Case No. AP-18-08, June 2014, available at **https://www.sos.mo.gov/cmsimages/securities/orders/AP-14-08.pdf**.

[37] Summary Revocation Order, CRD #2546369, Sept. 2015, available at **http://www.njconsumeraffairs.gov/Actions/Parthemer_Aaron_Robert_CRD2546369_Summary_Revocation_Order_09_11_2015.pdf**.

In November of 2015, the Alabama Securities Commission found that a financial advisor had invested in another investment advisor's hedge fund that was a Ponzi scheme. The advisor knew the other advisor was engaging in unapproved OBAs and did not report the activities or even disclose his involvement with the investment.[38]

In December of 2015, the New Jersey Bureau of Securities found that a financial advisor had failed to disclose their operation of an independent insurance agency, which their employment contract did not permit. The financial advisor also failed to cooperate during his FINRA examination, and as a result, the advisor's registration was revoked.[39]

6. Efforts to Promote State Regulatory Compliance

Based on the examples above, in order to facilitate compliance with state regulatory requirements, firms should:

- Notify their state regulators once a FINRA inquiry regarding OBAs has begun.
- Follow through on the policies and procedures they have instituted and make sure financial advisors understand the policies, their obligations, and are abiding by them.
- Properly educate supervisors in the firm on how to detect and respond to red flags indicating potential undisclosed OBAs.

VI. What practices have FSI member firms adopted with regard to OBA?

In order to assist our members in their OBA compliance efforts, FSI surveyed several member firms concerning their approach to reviewing and approving OBAs. We hope this information will serve as a resource to all members who seek to benchmark their current approach to reviewing OBAs. Each section begins with general firm characteristics and then analyzes how and what types of activities are permitted by the firm. Additionally, Appendix I contains a template OBA approval request form developed by FSI's Compliance Council that provides an example of a common means of collecting information from financial advisors about their desired OBAs.

Proactive Practices of FSI Member Firms

As outlined in prior sections of this paper, it is often the undisclosed OBA that creates significant issues for firms and investors. As such, it is important for firms to proactively seek out information that may identify an undisclosed OBA or a selling away venture. A poll of FSI member firms identified the following proactive approaches to uncover an undisclosed OBA:

- Annual or semi-annual attestations by financial advisors that all OBAs are reported to and approved by the firm. Some firms also send quarterly reminders to seek approval of any

[38] Admin Order No. SC-2015-00 23, available at **http://asc.alabama.gov/Orders/2015/SC-2015-0023.pdf**.
[39] Summary Revocation Order, CRD # 1131332, Dec. 2015, available at **http://www.njconsumeraffairs.gov/Actions/Tepedino_Summary_Revocation_3Dec15.pdf**.

new OBAs since the attestation. Some firms will send the attestation prior to the annual branch exam so they can gather information prior to being on-site at the financial advisor's office.

- An annual report from the financial advisor reporting all OBAs and providing a reasonable estimate of the revenue from each OBA. This report can be used in conjunction with preparation for the annual branch examination.
- Web and public records searches of all financial advisors or targeted to financial advisors where a suspicion of an unreported OBA has been formed, for instance because of a significant decrease in production. In some instances firms do this manually while other firms utilize software to search for information indicating a potential undisclosed OBA.
- Annual branch examinations where supervision staff will interview not only the financial advisor but administrative staff as well.
- Requesting tax returns from a risk-based and/or random selection of of a percentage of financial advisors and then comparing the information from the tax return to reported revenue and production to identify any inconsistencies.
- Correspondence and e-mail review with an eye specifically toward identifying potential OBAs and/or selling away.
- Money movement surveillance and/or annual review of the financial advisor's finances.
- Review of Forms U4 and U5, particularly for information disclosed through prior registrations with other firms.
- Use of software that tracks changes to financial advisor's websites so the firm can match changes made against the approved website.
- A regular review of OBA requests that were not approved. Unapproved OBAs trigger an in-person follow-up at the advisor's office to ensure they are not engaging in the OBA despite the firm disallowing it. Unapproved OBAs are also noted in the supervision records so the branch exam will include a concerted approach to uncover if the financial advisor is engaging in the disapproved OBA despite the fact that it was disapproved by the firm.

To further assist FSI members, FSI partnered with Eversheds Sutherland on May 12, 2017 to provide a webinar detailing the regulatory requirements and challenges surrounding OBAs. Participants were able to submit questions during the webinar and the following are several common questions that arose during the webinar along with the answers provided by Eversheds Sutherland:

Q. If a registered representative owns rental property or has a listing on a site like AirBnB, does that constitute an OBA that needs to be disclosed to a member subject to FINRA Rule 3270?

A. Whether rental property needs to be disclosed as an OBA depends on the nature of the registered person's relationship with the rental property. With regard to AirBnb, practices seem to vary among firms. FINRA Rule 3270 states that registered persons do not need to provide prior written notice to their firms before owning passive investments, but it does not define what constitutes a "passive" investment. Instead, it will depend on the facts and circumstances of the situation. Investing in real estate can be passive or active, and again, this will depend on the facts and circumstances. Investments in real estate may be considered active where investors purchase and manage properties for rental income, renovate properties for a profit, or build and sell new homes. On the other hand, investments in real estate-related mutual funds or real estate investment trusts (REITs) may be considered passive and at any rate, these investments would fall under the private securities transaction rule. Firms may want to set forth guidelines for registered representatives outlying common facts and circumstances that may lead the firm to consider a real estate investment as active or passive.

Q. Does an unpaid board position for an organization, including a nonprofit, museum, or condo association, constitute an OBA?

A. FINRA Rule 3270 states that a registered person must provide written notice to a firm if she wishes to be a "director." While the rule is not clear whether uncompensated director positions are considered OBAs, this question was addressed during the rulemaking stage. In the final order approving the rule, the SEC pointed out that FINRA addressed comments to this effect by stating the "rule prohibits a registered person from either acting in one of the enumerated roles or [emphasis added] from being compensated by, or having the reasonable expectation of compensation from, any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior notice to the member."[40] As such, an unpaid board position, even if for a non-profit organization, falls within the definition of an OBA that must be disclosed to the firm. Additionally, consideration should be given as to whether the position could potentially transition from unpaid to paid in the future and/or whether the position provides the registered person access to accounts or funds.

Q. How should firms determine whether an activity is a PST rather than an OBA? Under what circumstances do firms have to supervise PSTs?

A. FINRA Rule 3280, which applies to all associated persons of a member firm (including both registered and non-registered persons), states that PSTs are "any securities transaction outside the regular course or scope of an associated person's employment with a member." The distinction between an OBA and a PST may be, at times, opaque. The critical distinction is that a PST involves a securities transaction, while an OBA does not involve a securities transaction. In other words, if it involves a securities transaction it is by definition a PST.

The level of supervision required of PSTs is determined by whether an associated person "has received or may receive selling compensation" in connection with the transaction. If a firm approves a PST for compensation, the transaction must be "recorded on the books and records of the member" and the transaction needs to be supervised as if it "were executed on behalf of the member."

Firm A

Firm A is an IBD with approximately 1,600 financial advisors. Firm A requires their financial advisors to submit a form to their compliance department. Financial advisors are not permitted to participate in an OBA until the compliance department acknowledges the activity. Additionally, it

[40] FINRA OBA Rule, 74 Fed. Reg. 53362, 53364 (August 31, 2010). Also available here: **http://www.finra.org/sites/default/files/RuleFiling/p121995.pdf**

is the financial advisor's responsibility to ensure that the form is up to date. Firm A also requests information regarding changes to an advisor's OBA during the firm's annual audit.

1. Approval process

On their OBA disclosure form, Firm A asks several questions including:

- type and nature of the activity,
- start date,
- estimated time the advisor would spend on the OBA,
- advisor's role and ownership stake,
- names of clients, if any,
- location,
- compensation received,
- other persons involved,
- source of capital,
- any transaction authority or investment decision authority,
- fund control, and
- how it is being marketed.

Financial advisors must attest to the status of their OBAs on annual certifications and also notify the firm of an OBA termination. This firm uses a field OSJ to review and sign a disclosure form. The firm also requires their home office compliance staff to acknowledge that they have reviewed the activity as well.

2. What types of OBAs are financial advisors not allowed to engage in?

Firm A denies OBA requests involving:

- bill paying,
- acting in control of a client,
- any other activities involving control over client funds,
- variable life settlements,
- viatical settlements, and/or
- acting as an authorized person on a non-profit account.

Regarding non-profits, Firm A requires the financial advisor to provide an indemnity letter signed by an officer of the non-profit, who is not the advisor, to allow the advisor to have transaction authority outside the scope of activities as an advisor. Additionally, Firm A prohibits any marketing activity designed to promote a security.

If an OBA is denied, the denied activity is recorded on the financial advisor's compliance record and referenced during audits, correspondence and advertising reviews.

3. What policies and procedures do you have in place to deal with OBAs?

Firm A educates their financial advisors through:

- firm element teleconferences,
- continuous articles,
- publication of regulatory notices related to OBAs,
- annual compliance questionnaire, and
- educates advisors with presentations.

These training opportunities are provided on an ongoing basis. Financial advisors are also updated of regulatory changes through formal policy changes and video conferences.

4. <u>What would your firm do if they discovered a financial advisor did not disclose an activity?</u>

Firm A would first determine if the activity is ongoing. The firm would require the advisor to disclose the activity and then fully vet it to determine whether or not the firm would object to the advisor continuing with it. While the review is occurring, the advisor must stop participation in the activity.

The firm's disciplinary action for lack of disclosure of an OBA depends on several factors including:
- the activity,
- the extent of the firm's policy which was violated,
- whether there is evidence that the advisor was aware that they needed to disclose and did not, and
- whether the field OSJ was aware of the activity.

Disciplinary actions may include cautionary letters, fines and, if warranted, termination for cause.

5. <u>What procedures do you follow to discover unreported OBAs?</u>

Firm A has several procedures in place to discover unreported OBAs through:
- audits,
- correspondence review,
- monetary movement exception reports,
- advertising review,
- conducts ongoing conversations with financial advisors and their staff members,
- branch office exams,
- review of branch financial statements, and
- corresponding audit of advisor's bank statements.

<u>Firm B</u>

Firm B is an independent broker-dealer with approximately 300 financial advisors. Firm B requires their advisors to submit a form to their supervisor. The information on the form is submitted and retained through an intranet system that also maintains evidence of the conditions or limitations of the approved activities.

Generally permitted activities consist of non-securities, insurance and non-profit activities. It is the responsibility of the financial advisor to ensure that their OBA information is up to date. The firm will annually collect details about the types of OBAs their financial advisors engage in.

1. Approval process

On their OBA approval form, Firm B asks several questions including:

- type and nature of the activity,
- a description of the duties,
- their title in the organization,
- financial interest in the organization,
- start date,
- estimated time the advisor would spend on the OBA,
- compensation received and how it will be paid,
- location, and
- description of the relationship between the firm and the organization or company.

This information is periodically reviewed by senior compliance staff and the financial advisor's supervisors. Financial advisors must attest on annual certifications about the status of their OBAs and can also notify the firm of any OBA termination.

2. What types of OBAs are financial advisors not allowed to engage in?

Firm B generally denies OBA requests involving:

- PSTs, and
- hedge fund formation activities.

3. What policies and procedures do you have in place to deal with OBAs?

Firm B conducts:

- annual compliance meetings,
- publishes periodic compliance bulletins,
- requires annual attestations, and
- educational training programs for its financial advisors, both annually and periodically.

When regulatory updates or changes occur, financial advisors are notified about these changes through compliance bulletins and targeted memos.

4. What would your firm do if they discovered a financial advisor did not disclose an activity?

Upon discovery of the undisclosed activity, the firm will question the financial advisor regarding the activity. The firm then requires a written explanation from the advisor as to why the activity was not disclosed. The supervisor and/or CEO then determines appropriate disciplinary action on a case-by-case basis.

5. What procedures do you have to discover unreported OBAs?

Firm B seeks to discover non-disclosed activities through:

- client complaints,
- exam process,
- email review,
- a review of the independent financial advisor's website,
- publically available information searches,
- Secretary of State filings, and
- tax return reviews.

Financial advisors must also provide a reasonable estimate of income derived from each OBA annually. This data is used for year over year trend analysis. Advisors who have material changes in production over historical trends or sales production that has fallen to a concerning level will be requested to provide copies of credit reports, the prior year's personal and business tax return(s) and/or bank statement records. The firm will also randomly select financial advisors who engage in OBAs to further review their records. Any concerns identified from these reviews will be elevated to the CEO for evaluation and appropriate disciplinary action will be taken as needed.

Firm C

Firm C is an independent broker-dealer with more than 2,000 financial advisors. Firm C utilizes an outside vendor to review OBAs. Firm C also requires advisors to submit a disclosure questionnaire. A permanent record of the OBA decision is maintained by an outside vendor. The outside vendor interacts directly with Firm C's compliance department to notify them when an OBA is approved and the financial advisor's CRD record is updated.

1. Approval process

On the approval form, financial advisors are asked baseline questions to gain sufficient understanding about all aspects of the OBAs. These questions include:

- duties for the financial advisor,
- time spent on the OBA, and
- income derived from the OBA.

Firm C also asks questions that are specifically tailored to the particular activity.

Initial OBA requests are reviewed by Firm C's home office principals or field OSJs, based on the financial advisor disclosing the OBA. If a field OSJ reviews an OBA, there is a secondary review done by a home office principal.

2. What types of OBAs are financial advisors not allowed to engage in?

Firm C denies OBAs that involve:

- custody of client assets,
- engage in the solicitation of debt or equity in ventures outside of products offered by
- Firm C,
- raise investment capital,
- lease financing,
- investment banking,
- bill paying services,
- acting as a fiduciary for non-family member accounts, and/or
- acting as a money manager for a mutual or hedge fund.

If an OBA is denied, Firm C's branch exam teams have access to Firm C's outside vendor's records of approved or rejected OBAs to ensure compliance.

3. <u>What policies and procedures do you have in place to deal with OBAs?</u>

Advisors are informed of these policies and procedures during their onboarding process. Advisors are required to submit an annual attestation regarding OBAs.

4. <u>What would your firm do if they discovered a financial advisor did not disclose an activity?</u>

Firm C would first evaluate the situation and determine the circumstances as to why the OBA was not disclosed and handle it accordingly. The firm's response could vary from a letter of caution to termination. Termination would be applicable where a financial advisor purposely did not disclose the OBA because they knew it would not be approved.

5. <u>What procedures do you have to discover unreported OBAs?</u>

Firm C seeks to discover non-disclosed activities through:
- email reviews,
- branch exams,
- conduct analysis of financial advisors' checking account records,
- review written correspondence to look for evidence of unreported OBAs,
- interview office staff, and
- examine any informational materials in the office.

<u>Firm D</u>

Firm D is an independent broker-dealer with over 6,500 financial advisors. Firm D utilizes both a paper form and a web-based program to review OBAs. All OBAs are reviewed by the Regional Supervision Officer (RSO). The home office also maintains copies of the following documentation about the OBA review such as guidelines, restrictions, disclosure letters and examples of activities.

Firm D typically allows the following types of OBAs, but approval will ultimately depend on the advisor's role: non-securities, involvement in non-profits and insurance OBAs such as fixed, health, property and casualty insurance. Variable annuity involvement must be pre-approved by the firm prior to involvement.

1. Approval process

On the approval form, Firm D asks several questions:

- name of the business,
- advisor's responsibilities in the role,
- if the OBA has a website,
- where the OBA will be conducted,
- hours that will be devoted to the OBA,
- involvement of clients or other individuals with the OBA,
- type of organization, if it is public and if the advisor own shares,
- if the advisor has custody or control of funds such as check writing authority,
- compensation received, and
- if the advisor raises capital or assists in raising capital and if this was done through crowdfunding.

The Regional Supervisory Officer (RSO) for the respective region reviews all OBA requests. For new support staff (including non-registered associates) and financial advisors, OBA's must be reported prior to their start date through a paper submission. This submission is reviewed by the RSO or Regional Management Associate.

For existing advisors and staff, all OBA information is entered into an online program available to all advisors with log-in capabilities. Advisors are required to attest to each activity on an annual basis and reaffirm their participation in the respective OBAs. The advisor has the option to reaffirm the activity with no changes, or to edit and amend the OBA if something has changed.

2. What types of OBAs are financial advisors not allowed to engage in?

Firm D typically denies OBAs that involve:

- check writing responsibilities,
- handling funds,
- trustee positions,
- being a beneficiary,
- being a power of attorney for clients (non-immediate family),
- being a mortgage broker for clients,
- private securities transactions,
- some political activities,
- sale of viatical/life settlements,
- offering health savings accounts, and/or
- being an escrow agent.

If an OBA is rejected, a call is first made to inform the advisor that the activity has been declined. The online system will show the denial of the activity. Then various next level reviews will occur including an email review and branch exam. The firm will provide the advisor with the rationale for the rejection of the activity over the phone and through email. The firm will also put notes regarding the rejection into the online system.

3. What policies and procedures do you have in place to deal with OBAs?

Firm D provides written information regarding the process to all advisors online. The firm educates their advisors regarding these policies through:

- annual interviews,
- continuing education seminars,
- annual branch examinations,
- supervisory visits,
- email communication from the home office, and
- educational training programs at least annually.

4. What would your firm do if they discovered a financial advisor did not disclose an activity?

Firm D's response will depend on the activity discovered. The response could be escalated to upper management such as the Regional Manager, Director of Supervision, and/or CEO if warranted. Depending on the activity, the response could result in fines, a required letter of understanding from the advisor, a letter of caution to the advisor or termination. The severity of the response will depend on the nature of the violation.

5. What procedures do you have to discover unreported OBAs?

Firm D seeks to discover unreported OBAs through:

- email review,
- Google searches,
- state corporation searches,
- annual branch examinations,
- website reviews (Facebook, LinkedIn, etc.),
- branch manager questionnaires,
- computer reviews, and
- physical examination of branch and client files.

Firm E

Firm E is an independent broker-dealer with over 9,000 independent financial professionals. Firm E utilizes a paper form to review and determine whether a financial advisor can participate in the OBA. These written requests are then reviewed by one or more supervisory personnel.

Firm E typically allows the following types of OBAs, but it will depend on the advisor's role: non-securities (unless they require financing or client involvement), involvement in non-profits that are not political activities and fixed insurance OBAs which may also be subject to some limitations.

1. Approval process

On the approval form, Firm E asks several questions that will vary based on the nature of the activity:

- name of the business,
- advisor's responsibilities in the role,
- whether the activity is for profit or non-profit,
- if the activity is financially-related or not,
- where the OBA will be conducted, and
- number of hours that will be devoted to the OBA.

Designated members of the supervision and compliance departments will review all OBA requests. Advisers are required to submit annual certifications regarding their activities. All OBAs are also reviewed during routine branch office examinations.

2. <u>What types of OBAs are financial advisors not allowed to engage in?</u>

Firm E typically denies OBA requests involving:

- political activities,
- politically controversial activities, and/or
- activities that require more than 50% of the advisor's time.

If an OBA is rejected, the firm will provide the financial advisor with a letter and a phone call explaining the decision. With the exception of independent registered investment advisors, the firm generally limits the process to approving or denying the activity.

3. <u>What policies and procedures do you have in place to deal with OBAs?</u>

Firm E requires their advisors to annually certify that they have participated in educational training and other programs to ensure they are up to date on both firm specific and regulatory policies. When necessary, advisors will be informed regarding changes to OBA regulation.

4. <u>What would your firm do if they discovered a financial advisor did not disclose an activity?</u>

Firm E's response will depend on the activity discovered. The response could result in: fines, a required letter of understanding from the advisor, a letter of caution to the advisor or termination. The severity of the response will depend on the violation. If the OBA was financial in nature then the discovery of the unreported activity may result in sanctions or termination for cause. If the activity was something else, then the likely result will consist of lesser disciplinary sanctions.

5. <u>What procedures do you have to discover unreported OBAs?</u>

Firm E's response for seeking to discover undisclosed OBAs indicates it depends on the circumstances. The firm reviews correspondence and client complaints. The firm also conducts regular branch exams. Both should allow the firm to discover a financial advisor participating in an undisclosed activity. In certain situations, the firm will validate income derived through certain activities through reviewing the financial advisor's tax returns.

Firm F

Firm F is an independent broker-dealer with over 2,000 financial advisors. Firm F uses a web-based application to review and determine whether a financial advisor can participate in OBAs. Advisors can access this system and make changes and revisions to their reported activities whenever their position in an OBA changes.

Firm F typically allows the following types of OBAs: insurance, non-securities and non-profits.

1. Approval process

On the approval form, Firm F asks questions to get a general understanding of the activity and focuses on conflicts related to control over finances. If the answers reflect more than just an individual investment, such as client investment in the activity, the firm is likely to ask additional questions to inquire further into the matter. There are no hard rules regarding time constrictions for OBA involvement. But if the firm believes that the financial advisor would not be able to reasonably perform their duties as a financial advisor due to time constraints imposed by the activity, then the activity may be potentially rejected until further clarification with the individual and their Office of Supervisory Jurisdiction (OSJ) supervisory principal has occurred.

All submitted and revised OBAs are reviewed by the OSJ supervisory principal. The OSJ supervisory principal must approve the OBA before its final review by the Home Office compliance department. Most OBAs are reviewed individually, though if necessary a committee of individuals comprised of compliance and advocacy/supervision associates will review the activity. Firm F requires the disclosure of volunteer activities, memberships and other passive activities only if the financial advisor has a controlling position within the activities such as being the treasurer or serving on a board of a company or organization.

2. What types of OBAs are financial advisors not allowed to engage in?

Firm F typically denies OBA requests involving:

- present an unmitigated conflict of interest,
- could present either direct or indirect harm to clients,
- are venture capital,
- are angel investing, and/or
- being a fiduciary while they are being the representative of record for that client.

If an OBA is rejected, at minimum, there must be a note put into the web-based system informing the advisor of the rejection and any additional terms or conditions surrounding the review. All additional supervisory restrictions or measures are determined on a case-by-case basis.

Firm F allows advisors to be dually registered as a representative and an investment advisor. For these advisors the firm provides ongoing checks regarding their OBAs during their regular branch exams.

3. <u>What policies and procedures do you have in place to deal with OBAs?</u>

Firm F provides all of its advisors and representatives' regular training which includes:

- live presentations,
- recorded presentations,
- bulletins, and
- distributes an annual questionnaire that must be completed by each financial advisor or representative.

4. <u>What would your firm do if they discovered a financial advisor did not disclose an activity?</u>

Firm F's response upon discovering an undisclosed OBA depends on the nature of the activity discovered. Firm F would first review the facts and circumstances surrounding the situation and then determine whether the failure to disclose was an oversight with little implication or if it was intentionally undisclosed and could or did cause harm to an client or the firm. The disciplinary process would match how severe the failure to disclose was. The firm would begin by notifying the financial advisor and then any of the following could occur, depending on how the situation was evaluated: educational letter, formal cautionary letter, fine or other corrective actions up to and including termination.

5. <u>What procedures do you have to discover unreported OBAs?</u>

Firm F seeks to discover unreported OBAs through:

- branch office exams,
- physical item reviews,
- advertisements,
- websites,
- local public listings in the branch,
- consolidated production records,
- financial records of the securities practice, and
- books and records of any approved OBAs.

At the same time as the branch office inspection, Firm F also performs a financial review of OBAs to see if the information is reasonably consistent with the information reported on the OBA submission form. The firm will note when a financial advisor's estimated production income plus reported OBA income seems to be low compared to the financial advisor's lifestyle.

<u>Firm G</u>

Firm G is an independent broker-dealer with approximately 900 financial advisors. Firm G uses an electronic application to review and determine whether a financial advisor can participate in OBAs. Advisors can access this system and make changes and revisions to their reported activities whenever their position in an OBA changes.

Firm G typically allows the following types of OBAs: insurance, non-securities and non-profits.
1. <u>Approval process</u>

On the approval form, Firm G asks questions to get a general understanding of the activity and focuses on conflicts related to control over finances. There are no hard rules regarding time constrictions for OBA involvement. If the firm believes that the financial advisor would not be able to reasonably perform their duties as a financial advisor due to time constraints then the activity may be denied. Advisors are allowed to be involved with PSTs but they are usually subject to pre-approval and the review process is very stringent, resulting in few approvals.

All submitted and revised OBAs are reviewed by the financial advisor's supervisor. The supervisor must approve the OBA before the final review by the compliance principal. The financial advisor will be notified in writing of the approval or rejection of the OBA and the supervisor will provide the advisor with any additional information regarding potential limitations or restrictions. The electronic system will also be updated accordingly as well.

2. <u>What types of OBAs are financial advisors not allowed to engage in?</u>

Firm G typically denies OBA requests involving:

- present an unmitigated conflict of interest,
- could present either a direct or indirect harm to clients,
- venture capital,
- selling life settlements,
- angel investing, and/or
- being a fiduciary while they are being the representative of record for that client.

If an OBA is rejected, at minimum, there must be a note put into the web-based system informing the advisor of the rejection and any additional terms or conditions surrounding the review. All additional supervisory restrictions or measures are determined on a case-by-case basis.

3. <u>What policies and procedures do you have in place to deal with OBAs?</u>

Firm G provides annual training through either their annual compliance meeting or their required firm element training. The training ensures that advisors are up to date on both firm specific and federal regulatory policies.

4. <u>What would your firm do if they discovered a financial advisor did not disclose an activity?</u>

Firm G's response is conducted on a case by case basis depending on the activity discovered. The firm would first need to review the facts and circumstances surrounding the situation and then determine whether the failure to disclose was an oversight with little implication or if it was intentionally undisclosed and could or did cause harm to an client or the firm. The disciplinary process matches the severity of the failure to disclose and ranges from issuing a letter of instruction, a letter of caution often with a fine, a letter of discipline or potential termination. Any of those steps can be skipped if the situation warrants it. Generally all letters are issued by the

Vice President of the company.

5. What procedures do you have to discover unreported OBAs?

Firm G seeks to recover unreported OBAs through:
- branch office exams,
- physical review of items,
- advertisements,
- listings located in the branch,
- reimbursement process,
- investigations prompted by other issues,
- background checks when contracts are changed, and
- other changes that occur with the financial advisor.

Firm H

Firm H is an independent broker-dealer with over 3,400 financial advisors. Firm H utilizes a paper questionnaire form to review and determine whether a financial advisor can participate in OBAs. Advisors are required to ensure that this information is always current.

Firm H typically allows the following types of OBAs: insurance, non-securities and non-profits.

1. Approval process

On the questionnaire form, Firm H asks several questions including:
- type and nature of the activity,
- start date,
- estimated time the advisor would spend on the OBA,
- advisor's role and ownership stake,
- names of clients, if any,
- location,
- compensation received,
- other persons involved,
- source of capital,
- any transaction authority or investment decision authority,
- fund control, and
- how it is being marketed.

All questionnaires are reviewed by the compliance principal at the home office. The firm urges advisors to err on the side of caution and disclose all activities including non-profit involvement.

2. What types of OBAs are financial advisors not allowed to engage in?

Firm H typically denies OBA requests involving:
- present an unmitigated conflict of interest,

- could present either a direct or indirect harm to clients,
- any viatical settlement products,
- any sale of precious metals,
- promissory notes,
- allow discretion in non-managed accounts,
- are a trustee for client accounts,
- are a power of attorney,
- are listed as the beneficiary, and/or
- similar activities unless the client is also an immediate family member.

Advisors are not allowed to engage in any OBAs that are listed in the prohibited activities section of the firm's Compliance Guide.
If an OBA is rejected, the compliance principal who reviews the activity will indicate why the OBA was denied on the questionnaire. This form is kept on file at both the home and branch office and a copy is sent to the advisor.

3. What policies and procedures do you have in place to deal with OBAs?

Firm H provides recurring field notice reminders that are distributed to the branch office twice each year, normally in the first quarter and third quarter. The firm also has an online annual compliance questionnaire that all associated persons are required to answer. Four to five of those questions on the questionnaire deal specifically with OBAs. The firm also monitors OBA involvement in annual branch exams.

4. What would your firm do if they discovered a financial advisor did not disclose an activity?

Firm H's response is based on a case by case basis depending on the activity discovered. The firm would first need to review the facts and circumstances surrounding the situation and then determine whether the failure to disclose was an oversight with little implication or if it was intentionally undisclosed and could or did cause harm to an client of the firm. The disciplinary process would match how severe the failure to disclose was. The firm's response could include a letter of caution, fine, suspension or termination.

5. What procedures do you have to discover unreported OBAs?

Firm H focuses on OBAs when conducting branch office exams. Examiners review:

- materials available in the waiting area,
- client compliance,
- checkbook ledger review,
- conversations with staff,
- client complaints, and/or
- email surveillance or other similar monitoring systems that the firm uses.

Firm I

Firm I is an independent broker-dealer with over 3,500 financial advisors. Firm I utilizes a paper questionnaire form to review and determine whether a financial advisor can participate in OBAs. Advisors are required to update their forms which are reviewed internally by the home office.

Firm I is unique because many of their financial advisors work part-time and are employed by other businesses. Firm I approves certain types of non-profit, insurance and non-securities activities.

1. <u>Approval process</u>

On the questionnaire form, Firm I asks several questions including:

- type and nature of the activity,
- start date,
- advisor's role and ownership stake,
- names of clients, if any,
- name of partners, if any,
- location,
- website,
- compensation received,
- other persons involved,
- source of capital,
- any transaction authority or investment decision authority,
- fund control, and
- how it is being marketed.

All questionnaires are reviewed by the home office. The firm urges advisors to err on the side of caution and disclose all activities including non-profit involvement.

2. <u>What types of OBAs are financial advisors not allowed to engage in?</u>

Firm I typically denies OBA requests involving:

- any OBAs where financial advisors act with discretionary authority in non-managed accounts,
- being a trustee,
- being a power of attorney,
- being listed as the beneficiary or similar activities unless the client is also an immediate family member, and/or
- raising money (even for non-profits) or soliciting clients.

If an OBA is rejected, the compliance team will first discuss the activity with the advisor to better understand the activity. Advisors will be told if the activity is prohibited. Advisors will receive a formal letter stating the reason for the denial. The letter is also sent to the advisor's supervisor and a copy is retained at the home office. Activities that the home office views as high risk are noted and reviewed annually.

3. <u>What policies and procedures do you have in place to deal with OBAs?</u>

Firm I provides annual training for all financial advisors at their annual compliance and firm training meetings. Branch offices conduct additional trainings. Firm I sends out field bulletins through their intranet system informing advisors about regulatory changes and reminding advisors about their disclosure obligations. Firm I also sends out newsletters every three to six months that remind advisors of their disclosure obligations. Lastly, the firm monitors OBA involvement in annual branch exams.

4. <u>What would your firm do if they discovered a financial advisor did not disclose an activity?</u>

Firm I's response is done on a case by case basis depending on the activity discovered. The firm establishes a case and begins researching the OBA. The firm will then reach out to the advisor. If the activity is approved after it is discovered, the licensing department updates the advisor's record. The firm would also send a formal letter reminding the advisor of their ongoing obligation to disclose all OBAs. If the activity is not approved then the advisor would be disciplined, potentially with termination if appropriate. All responses would be documented and a record is kept in the home office.

5. <u>What procedures do you have to discover unreported OBAs?</u>

Firm I's conduct focuses on OBAs during their branch office exams through review of:

- materials available in the waiting area,
- client complaint,
- checkbook ledger review,
- conversations with staff,
- email surveillance,
- social media surveillance, and
- other similar monitoring systems that the firm uses.

<u>Firm J</u>

Firm J is an independent broker-dealer with over 10 financial advisors. Firm J utilizes a paper questionnaire form to review and determine whether a financial advisor can participate in OBAs.

Firm J typically allows the following types of OBAs: insurance, non-securities and non-profits.

1. <u>Approval process</u>

On the approval form, Firm J asks questions to get a general understanding of the activity and focuses on conflicts related to control over finances. Firm J asks the advisor to describe the activity and specify how many hours they plan on devoting to it. If there are still questions about the activity, the firm will follow up with the advisor and document the conversation.

The Senior Compliance Officer will begin review of the activities and the President will have final approval.

2. <u>What types of OBAs are financial advisors not allowed to engage in?</u>

Firm J typically denies OBAs that present an unmitigated conflict of interest and could present either a direct or indirect harm to clients. While Firm J does not have hard rules prohibiting OBAs, typically they do not approve:

- PSTs,
- any OBAs where financial advisors act with discretionary authority in non-managed accounts,
- being a trustee,
- being a power of attorney, and/or
- being listed as the beneficiary or similar activities unless the client is also an immediate family member.

If an OBA is rejected, the compliance team will inform the advisor of the rejection and reasoning about why it was denied. Firm J will also document the denial in the advisor's file.

3. <u>What policies and procedures do you have in place to deal with OBAs?</u>

Firm J provides annual training for all financial advisors at their annual compliance and firm training meetings. Firm J sends regulatory updates through email and discusses them in further detail at monthly meetings to ensure that all advisors understand the changes.

4. <u>What would your firm do if they discovered a financial advisor did not disclose an activity?</u>

Firm J's response will depend on the activity discovered. The firm would first review the facts and circumstances surrounding the situation and then determine whether the failure to disclose was an oversight with little implication or if it was intentionally undisclosed and could or did cause harm to a client or the firm. The disciplinary process would match how severe the failure was to disclose. First, a notification would be sent to the financial advisor and then any of the firm could of any of the following: send an educational letter, send a formal cautionary letter, impose a fine or other corrective actions up to and including termination.

5. <u>What procedures do you have to discover unreported OBAs?</u>

Firm J seeks to discover unreported OBAs through:

- internet searches,
- reviewing advisors' annual attestations,
- discussions with clients, and
- review of personal accounts.

<u>Firm K</u>

Firm K is an independent broker-dealer with over 1,500 financial advisors. Firm K utilizes an electronic form to review and determine whether a financial advisor can participate in OBAs.

1. <u>Approval process</u>

On the questionnaire form, Firm K asks several questions including:
type and nature of the activity,

- start date,
- advisor's role and ownership stake,
- names of clients, if any,
- name of partners, if any,
- location,
- website,
- compensation received,
- other persons involved,
- source of capital,
- any transaction authority or investment decision authority,
- fund control,
- and how it is being marketed.

All questionnaires are reviewed by the advisor's Designated Supervisory Principal (DSP). Once the DSP approves the activity it then undergoes a final review by the Compliance Department to provide the final approval. The Compliance Department looks at various risk perspectives of the OBA to determine if the DSP appropriately addresses all identified risks. The Compliance Department will also check to see if the activity conflicts with other activities and products sold by the firm.

2. <u>What types of OBAs are financial advisors not allowed to engage in?</u>

Firm K typically denies OBAs that:

- present an unmitigated conflict of interest,
- could present either a direct or indirect harm to clients,
- independent RIAs,
- raise capital,
- solicit funds,
- sell prepaid legal,
- prepaid funeral,
- college funding, and
- multi-level marketing depending on the structure.

If an OBA is rejected, the DSP will discuss the conflicts of the activity and why it is denied with the financial advisor.

3. <u>What policies and procedures do you have in place to deal with OBAs?</u>

Firm K educates members during their annual compliance meetings and annual certification. Additionally, the firm provides audios with ad hoc supervisory and/or compliance bulletins

depending on the regulatory changes that occur.
4. What would your firm do if they discovered a financial advisor did not disclose an activity?

Firm K's response would depend on the activity discovered. The firm would ask the advisor to disclose the OBA to be reviewed. Firm K would remind the advisor of the firm's policy to disclose all activities. Then depending on the circumstances as to why the activity was not disclosed, a referral may be made to the firm's supervision department for any potential subsequent disciplinary action. Disciplinary actions could be any of the following: educational letter, formal cautionary letter, fine or other corrective actions up to and including termination.

5. What procedures do you have to discover unreported OBAs?

Firm K has several procedures in place to discover unreported OBAs, including visual clues, business cards, correspondence in files and interviews with advisors. The Home Office compliance department also conducts routine surveillance of advisor emails and monitors for communications that indicate the advisor is participating in an OBA.

VII. Conclusion

As defined by the rule, OBAs include any business activity outside the scope of the relationship with the financial advisor's firm. These activities can take a variety of forms and do not necessarily require compensation paid to the financial advisor. While OBAs can cause concern for securities regulators, OBAs provide value in that they allow financial advisors to better serve the needs and demands of their clients.

Recognizing the value of OBAs, firms have created extensive approval and monitoring efforts to comply with FINRA and state regulatory requirements related to OBAs and supervision in general. The surveyed firms require financial advisors they recruit to disclose their OBA activities prior to joining the firm and require advisors to annually assure that the disclosed information is accurate. Firms notify financial advisors regarding the approval or denial of the activity along with the rationale behind the firm's decision. All surveyed firms have established well-structured methods to ensure disclosed OBAs are disclosed in a timely and accurate manner and that advisors are kept abreast of the firms' policies. We hope the information provided by surveyed firms will serve as helpful tool to FSI member firms who are considering refinements to their OBA WSPs, examination efforts or related policies.

Appendix I

SAMPLE OUTSIDE BUSINESS ACTIVITIES DISCLOSURE FORM

All associated persons must provide prior written notice of any business activity outside the scope of his/her employment with this Broker/Dealer firm. (FINRA Rule 3270.)

Rep Name: ______________________________ Rep #: ________ Branch: ____________

☐ I am not currently (nor proposed to be) engaged in any outside business activities. (Check one box below)

☐ I use a Doing Business As name ("DBA") only for marketing and not for an outside business.

Name of DBA: ____

☐ I only market under the name of my Broker/Dealer.

(Skip rest of questions and sign form. Return to Compliance.)

☐ I am engaged (or proposed to be engaged) in outside business activities.

Examples include but not inclusive: Independent investment advisor; insurance; pension consultant; accounting/tax; law; board of directors outside company; trustee; civic; non-financial related employment.

(Answer all questions below and sign form. Return to Compliance.)

☐ Proposed activity estimated to commence: ______ ☐ Currently engaged in activity since: ______

Name of business: ____

☐ This is a Registered Investment Adviser (RIA). If checked attach Form ADV 1, 2A and 2B.

☐ This is an insurance related business.

Address of business: ____

Capacity you act in (owner/other financial interest, employee, independent contractor, volunteer) including title, duties and authority. Are you Treasurer or a financial officer? Do you have custody/control of funds/assets, check writing authority, act as trustee:

____

Describe the outside business activity (be specific about the business) and % of time engaged in activity:

____

How are you compensated (salary, hourly, commission, stock options, etc.). What is your annual income:

____

Private Securities Transactions

Does this activity involve private securities transactions (securities transactions away from this firm):

☐ No ☐ Yes

If yes, is it for compensation:

☐ No ☐ Yes

(Yes responses in this section will require additional disclosure on a separate form.)

I have read the attached FINRA Rule 3270 (Outside Business Activities) and Rule 3040 (Private Securities Transactions of an Associated Person). I understand my obligation to report all facts to my Broker/Dealer.

______________________________ ______________

Rep Signature Date

Principal Review: ☐ Form U4 to be amended ☐ Form U4 verified current Notes:

______________________________ ______________

Principal Signature Date

This form originally prepared by The Consortium® with permission for FSI use with the OBA Task Force.

Appendix II – Summary of FINRA OBA Guidance

Selected Notice 88-5 Request for Comments on Proposed NASD Rule of Fair Practice Regarding Outside Business Activities: The NASD requests comments on a proposed NASD Rule of Fair Practice that would require all persons associated with a member firm to provide prior written notice to the firm of certain outside business activities.

Selected Notice 88-45 Proposed New Rule: Outside Business Activities: NASD members are invited to vote on a proposed that would prohibit all persons associated with a member in any registered capacity from accepting employment or compensation from any other-person as a result of business activity outside the scope of the employment relationship with a member unless prompt written notice to the member firm is provided.

Selected Notice 88-86 Approval and Immediate Effectiveness of Article III, Section 43 of the NASD Rules of Fair Practice Regarding Outside Business Activities: The SEC has approved the new section that prohibits all persons associated with a member in any registered capacity from accepting employment or compensation from any other person as a result of business activity outside the scope of the employment relationship with a member unless prompt written notice to the member firm is provided.

Selected Notice 89-39 Proposed New Rule Re: Handling Customer Limit Orders: Members are invited to vote on a proposed new Section 45 that would set forth obligations of member firms that accept customer limit orders and continue their own market-making activities in the security that is the subject of the limit order.

Selected Notice 90-37 Proposed New Rule Re: Handling Customer Limit Orders: The NASD set forth its views that, on accepting a customer limit order, a member undertakes a fiduciary obligation and cannot trade for its own account at prices more favorable than the customer limit order unless there is an understanding by the customer as to the priorities that will govern the order.

Selected Notice 94-44 Clarification On Applicability Of Article III, Section 40 Of Rules Of Fair Practice To Investment Advisory Activities Of Registered Representatives: Clarifying the applicability of Article III, Section 40 of the NASD Rules of Fair Practice to the investment advisory activities of registered representatives.

Selected Notice 94-93 NASD Requests Comment On Proposed Rule Governing Registered Persons Lending To Or Borrowing From Customers: The proposed rule would require registered persons to provide prior notification to, and obtain prior approval from, their employing member firm before personally borrowing funds or securities from a customer, or before personally lending funds or securities to a customer.

Selected Notice 96-33 NASD Clarifies Rules Governing RR/IAs: Notice discusses recordkeeping approaches and presents the answers to some of the most frequently asked questions regarding Section 40.

Selected Notice 01-79 NASD Reminds Members Of Their Responsibilities Regarding Private Securities Transactions Involving Notes And Other Securities And Outside Business Activities: This Notice reminds members that they should: (1) review their supervisory procedures to make sure that they are reasonably designed to achieve compliance with NASD Rules 3030 and 3040 regarding outside business activities and private securities transactions; and (2) appropriately educate their associated persons regarding the requirements of Rules 3030 and 3040.

Selected Notice 10-49 SEC Approval and Effective Date for New Consolidated FINRA Rules: Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA established a process to develop a new consolidated rulebook