NSCP
NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS

22 Kent Road
Cornwall Bridge, CT 06754

www.nscp.org
Phone (860) 672-0843
Fax (860) 672-3005

April 27, 2018

VIA ELECTRONIC MAIL

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
(pubcom@finra.org)

Re: Regulatory Notice 18-08 (February 26, 2018)

FINRA Requests Comment on Proposed New Rule Governing Outside Business Activities and Private Securities Transactions

Dear Ms. Mitchell:

The National Society of Compliance Professionals ("NSCP") submits this letter in response to the request by the Financial Industry Regulatory Authority, Inc. ("FINRA") for comments on a proposed new rule (the "Proposal") to address the outside business activities of registered persons. NSCP is a nonprofit, membership organization with approximately 2,000 members and is dedicated to serving and supporting compliance professionals in the financial services industry in both the U.S. and Canada. To our knowledge, NSCP is the largest organization of securities industry professionals in the U.S. and Canada devoted exclusively to compliance. In light of NSCP's focus on compliance and compliance professionals, our comments will be limited to concerns that impact compliance programs and/or compliance professionals.

NSCP begins its comments by commending FINRA for undertaking its retrospective rule review generally and specifically with respect to FINRA Rule 3270 (Outside Business Activities of Registered Persons) and FINRA Rule 3280 (Private Securities Transactions of an Associated Person), and for seeking comments on a proposed new rule to cover all such activities.

As Regulatory Notice 18-08 states, the Proposal's express goal is to "clarify the obligations in this area and reduce unnecessary burdens while strengthening protections relating to activities that may pose a greater risk to the investing public." NSCP strongly supports these goals and, in particular, agrees that reducing unnecessary supervisory and compliance burdens allow member firms to focus their supervisory and compliance efforts more efficiently and effectively, which should in turn better protect investors. NSCP believes that the Proposal's narrower scope is a strong step forward in better aligning member firm responsibilities with the risks actually faced by investors and, thus, will strengthen investor protections.

NSCP's responses to particular questions posed by FINRA's Regulatory Notice 18-08, which responses follow below, reflect the view of interested NSCP members who provided comments to NSCP in response to the Proposal.

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***Request for Comment**:*

1. What are the alternative approaches, other than the proposal, that FINRA should consider?

As stated above, NSCP is in general agreement with the approach reflected in Regulatory Notice 18-08. In particular, NSCP believes that several proposed provisions should substantially reduce compliance burdens of member firms without negatively impacting investor protections and, indeed, that such provisions are likely to have a salutary impact on investor protection. These provisions include Supplementary Material .01(c), which excludes from the proposed rule certain activities conducted on behalf of an affiliate of a member firm, paragraph (b)(4), which imposes supervisory, recordkeeping and other obligations upon member firms only in the limited situations described therein, and Supplementary Material .01(a), which excludes a registered person's personal investments from the proposed rule. Each of these changes should significantly reduce compliance burdens of member firms without negatively impacting investor protections. Moreover, by reducing unnecessary supervisory and compliance burdens, the Proposal allows member firms to better focus their supervisory and compliance efforts where they are needed, which, NSCP members believe, should lead to improved investor protection. In addition, the clear exclusion from the proposed rule for activities conducted on behalf of an affiliate and in connection with a registered person's personal securities transactions should significantly reduce confusion by investors as to the identity and nature of the entity or person with whom they are dealing, which should help the investor better understand the investor's relationship with its counterparty and the regulatory scheme applicable to that relationship.

NSCP does question, however, whether the language in paragraphs (b)(1)(B) and (b)(4) and Supplementary Material .01(c) that references whether the activity in question would require registration as a broker or dealer under the Exchange Act could be greatly simplified and improved, with no loss of investor protection, if it instead focused on the receipt of "transaction-based compensation," *e.g.*, finders fees, commissions, mark-ups, mark-downs, sales load and similar compensation that has the effect of providing the representative with a so-called "salesman stake" in the securities transaction. Although this standard is narrower than a broker-dealer registration standard, it is both much easier to apply and, because it is focuses on sales and investment-related activities is better tailored to protect investors.

The determination of whether activity might trigger broker-dealer registration can be complex and often is not susceptible of a definitive answer. Moreover, such a determination is one that most compliance officers, being already associated with a broker-dealer, rightly rarely focus upon and generally are not qualified to make. Rather than run the risk of being second guessed on the question of whether particular activity might trigger broker-dealer registration requirements, member firms are likely simply to disapprove a registered person's request to engage in investment-related activities involving securities. In contrast, conditioning these obligations on the receipt of transaction-based compensation in connection with securities transactions leads to a simpler, more straightforward determination while also having the added advantage of employing a term, "transaction-based compensation," that is already part of both current Rule 3280 and the proposed rule.

2. How would consolidation of the rules governing outside business activities and private securities transactions in this proposal simplify compliance? What impact would it have on the cost of compliance?

As noted in many of the earlier comments, outside business activities and private securities transactions often overlap and, in any event, the difference between the two is a regular source of confusion. This is particularly the case where the registered person is both an owner and an active participant in the business.

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While an active role in a business likely constitutes an outside business activity, changes in ownership may be deemed to constitute a private securities transaction if, for example, the business seeks additional capital, allocates or reallocates equity or debt among its owners or merges with another entity, among other, ordinary activities. Because these types of transactions frequently do not involve any selling efforts and take place between persons who are involved in the day-to-day operation of the business, even conscientious registered persons may fail to identify such transactions as private securities transactions. NSCP believes that combining outside business activities and private securities transactions in a single rule that excludes "buying away" activities, *i.e.*, personal securities transactions, will help avoid this confusion and result in a simpler and more streamlined compliance process both for covered persons and compliance.[1]

3. Unlike Rule 3280, the proposed rule would apply to registered persons, rather than to associated persons. Should the proposed rule be expanded to apply to all associated persons? If so, why?

NSCP believes that it is appropriate to apply the proposed rule to all registered persons while also recognizing that member firms are in the best position to determine who among their non-registered personnel, if any, should be subjected to similar obligations and restrictions.

4. Is the proposed scope of the notice requirement appropriately tailored to balance the interest of members to receive information regarding their registered persons' outside activities and any investor protection concerns?

a. Should the proposal be modified to require registered persons to provide notice with respect to a narrower set of activities? If so, should notice be required only with respect to investment-related or some other categorization of activities?

b. Would narrowing the scope of the proposal impose any additional risks to investors?

At a minimum, NSCP believes that the Proposal's notice requirement should not exceed that of Question 13 – Other Business – on Form U4. Accordingly, the notice requirement should not apply to non-investment-related activities that are "exclusively charitable, civic, religious or fraternal and [are] recognized as tax exempt." Indeed, because many civic, religious or fraternal organizations have not taken the step of applying for tax exempt status, NSCP would go even further and recommends that FINRA eliminate the requirement in Question 13 that conditions exclusion on volunteer activities being recognized as tax exempt.

Similarly, while the current and the proposed rules are both labelled as relating to "business activities," the actual language of the rules encompasses inherently non-business-related volunteer activities. For example, service as a non-compensated officer of a church, parent-teacher association, soup kitchen or a condo board are not truly related to *any* business venture and create no expectation of compensation. Requiring registered persons to reveal such roles can also be unnecessarily intrusive as such activities can be reflective of employees deeply held, and perhaps controversial, political positions, sexual orientation, medical conditions and other aspects of the employee's personal life that are not of any relevance to the member firm. To the extent that participation in unpaid roles with non-profit organizations creates risks to firms or clients (such as if the

[1] NSCP believes that it would be helpful if FINRA provides further guidance as to the application of the Proposal to the fact patterns discussed above and elsewhere herein and, in particular the impact thereon of the exclusion for personal securities transaction as set forth in Supplementary Material .01(a).

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registered person can direct the investments of the organization, if any, or solicit contributions from clients or counterparties), the former would be covered under the Proposal as "investment-related" and the latter is already addressed by FINRA's guidance on conflicts of interests and gifts and gratuities rules. Firms can obtain such information through their existing practices and controls on those issues without compelling disclosure of all volunteer work that involves an officer or director role.

NSCP further believes that both Question 13 on the Form U4 and the Proposal's notice requirement should be further revised to explicitly exclude from coverage non-investment related employment that would not be considered for purposes of Item 4 B. of Form ADV Part 2 B to be a "substantial source" of the individual's income or to involve a "substantial amount" of the individual's time. This would help further align the notice and disclosure requirements applicable to registered persons with those applicable to advisers and would have the added benefit of excluding many temporary, flexible or occasional jobs of a type that are on the increase as more registered people participate in the so-called "gig economy" and are involved in work away from the member firm as freelancers rather than full-time or even part-time employees. By way of example, should an occasional performance as a musician be considered a business activity? What about babysitting for a neighbor, tutoring, or selling home grown produce or crafts? While these types of jobs could generate minimal compensation and therefore might technically fall within the "business activity" definition, or at least are not clearly excluded therefrom, many persons covered by current FINRA Rule 3270 are unlikely to consider such activities as triggering a reporting requirement under FINRA Rule 3270 or Question 13 on Form U4.

The substantial time or compensation standard would also be helpful in the context of business activity that might have a "reasonable expectation of compensation." This standard can be difficult for even a seasoned compliance personnel as it is often difficult to pinpoint the moment when a business idea crosses the line from a concept to an activity that gives rise to a reasonable expectation of compensation. Under the substantial time or compensation standard, however, non-compensated business activities would only be required to be reported if the activity involved investment-related-activities or a substantial time commitment.

The substantial time or compensation standard also has the added benefit of excluding from the reporting requirements business activities of the type described above that raise minimal, if any, investor protection concerns while often serving as a potential trap for registered persons who may understandably fail to report such activities. While NSCP strongly agrees that all persons registered with FINRA are required to know and follow all applicable rules, NSCP also believes that rules should not be designed as a "gotcha" for something as inconsequential as gardening or playing the guitar. Moreover, while the reporting obligation may seem trivial, compliance and supervisory personnel are compelled to spend significant time, which could be better spent elsewhere, responding to questions, creating records of disclosures, and assessing the timeliness of such disclosures.

More generally, NSCP members had differing positions on whether the "business activity" definition should be limited to activities that are investment-related or applied more broadly. One the one hand, it is difficult to see the investor protection aspects of requiring disclosure of waiting tables, driving a taxi, serving on a non-profit board or a myriad of other non-investment related activities. While it is possible that an outside business activity could be viewed by a customer as a conflict or a perceived conflict, conflicts come in a variety of forms such that including all outside business activities in the Proposal for this purpose would seem to be a very blunt instrument. In any event, most member firms have procedures that require avoidance and disclosure of conflicts, whether perceived or real. On the other hand, some NSCP members were of the view that limiting the definition of "business activity" to activities that are investment-related, could lead to confusion as to what is covered by

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the proposed rule and, therefore, that a broader notice requirement was simpler and easier for both member firms and covered persons. On balance, NSCP believes that the "investment-related" definition is clear enough such that that this should not be a concern and that the broader notice requirement is itself one that many registered persons seem to have difficulty complying with when it comes to many non-traditional compensation activities. Of course, even in the absence of a mandated obligation, member firms would be free through their written supervisory procedures to impose such a requirement on their associated persons as they thought best in light of their specific circumstances and, in any event, registered persons would still be subject to the Form U4 reporting requirement that registered persons report whether they are currently engaged in "other business".[2]

Moreover, to the extent the Proposal maintains the current definition of "business activity", NSCP suggests that FINRA provide clarity as to whether the term "business activity" encompasses residual compensation, *i.e.*, from an activity in which the registered person is no longer an active participant, as well as income from rentals, including from short-term leases, *e.g.*, an Airbnb sublease of one's apartment or home, and other sub-leases, severance from a former job, copyrights, patents and other forms of passive or largely passive compensation. Also, as discussed above, guidance would be helpful with respect to the application of the Proposal to more casual and less regular compensation activities.

5. A member's obligation to conduct a risk assessment is only triggered under the proposal with respect to investment-related activities.

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

b. Is the definition of "investment-related," which is based on the definition used by the Form U4, appropriate given the regulatory objectives of the proposal, or should other activities be included in or excluded from the definition? If so, why?

c. The proposed rule's focus is on assessing the risks created by the registered person's engagement in the outside investment-related activity, rather than the underlying activity itself. Is this an appropriate focus? Should the risk assessment include a requirement for the member to perform due diligence of the underlying outside activity?

d. The member would be required in the risk assessment to evaluate whether the proposed activity will: (i) interfere with or otherwise compromise the registered person's responsibilities to the member's customers; or (ii) be viewed by customers 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. Are these appropriate criteria to evaluate conflicts of interests and other potential areas of harm to investors?

NSCP agrees that limiting the risk assessment obligation to "investment-related" activities would allow

[2] Regardless of FINRA's ultimate position on the "business activity" definition, NSCP members believe it would be helpful if FINRA provides guidance that either interprets the scope of the Proposal's business activity notice requirement in a manner that aligns with the Form U4 reporting obligations or, in the alternative, highlights the differences between the two obligations.

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FINRA members to focus their compliance efforts on activities that pose the greatest concern and potential harm to investors. NSCP members also thought that the use of "investment-related" is appropriate given the objectives of the Proposal and also that such term offered the benefit of clarity and would make compliance with the proposed rule easier. NSCP members also agreed that it is appropriate to limit the risk assessment to the risks created by the registered person's engagement in the outside investment-related activity rather than the underlying activity and thought the assessments that were required to be made as part of the risk assessment evaluation were appropriate and consistent with current practices.

6. The proposal has several exclusions, including for registered persons' personal investments and activities conducted on behalf of an affiliate of a member, unless those activities would require registration as a broker or dealer if not for the person's association with a member. Are the proposed exclusions appropriate?

a. Should any other activities be excluded from the rule? If so, why?

b. Should the proposed exclusions, including the exclusion for activities on behalf of affiliates, be limited in any manner? For example, should the exclusion be limited to activities on behalf of affiliates that are subject to federal or state financial registration or licensing requirements, such as registered investment advisers, banks and insurance companies?

As stated above in response to Question 4, NSCP has recommended a number of changes to the scope of the "business activity" definition, which changes would have the effect of excluding non-investment–related activities that are provided as a volunteer or that do not constitute a substantial source of income or involve a substantial time commitment.

As stated above in response to Question 1, conditioning an exclusion on whether activities would require registration as a broker or dealer introduces a determination that is frequently complex and may require consulting an attorney, which can be expensive and may still not lead to a definitive answer. Instead, and as discussed further at Question 1, NSCP suggests that conditioning the exclusion on the receipt of transaction-based compensation but only to the extent such compensation is in connection with a securities transaction. Also, as stated above in response to Question 4, NSCP suggests that FINRA provide clarity as to whether the term "business activity" encompass residual compensation, *i.e.*, from an activity in which the registered person is no longer an active participant, as well as income from rentals, copyrights, patents and other forms of passive compensation.

To the extent FINRA, however, considers narrowing any of the proposed exclusions, NSCP believes that the Proposal's exclusion of activities conducted on behalf of affiliates, as set forth at Supplementary Material .01(c), offers the most significant benefit to member firms with the least risk to investors. This is particularly true where the affiliates are themselves regulated entities and, therefore, can themselves be expected to have a supervisory and compliance program as required by applicable regulation. As to unregulated affiliates, their unregulated status reflects policy judgments under federal and state laws that their activities do not raise sufficient investor protection concerns as to justify regulation. In such case, imposing the regulatory burden on the FINRA member with which the registered person is associated ignores, and indeed overrides, this policy judgment and has the effect of imposing regulatory costs and burdens over and beyond what was deemed appropriate at the federal and state levels. This approach also creates the risk of imposing conflicting regulatory obligations. Moreover, as discussed further in NSCP's responses to Questions 7 and 8, requiring a member firm to supervise activity that is conducted at another entity is often difficult to the point of not being feasible.

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7. Unlike current Rule 3280 and related guidance, the proposed rule would not impose a general supervisory obligation over IA activities and would not require the member to record on its books and records transactions resulting from such IA activities. Does the treatment of IA activities under the proposed rule appropriately address investor protection concerns while recognizing that separate obligations exist under the IA regulatory regime?

NSCP members who commented on Question 7 agreed that the treatment of IA activities under the proposal, with its implicit recognition that separate supervisory and compliance obligations exist under the IA regulatory regime, appropriately addressed investor protection concerns. Indeed, requiring a member firm to supervise securities that are managed by an IA, whether affiliated or not, may potentially lead to customer confusion as to the entity responsible for the transaction and the appropriate regulatory and/or legal standards applicable to the services provided. Further, both affiliated and, particularly, unaffiliated IAs often engage in products and strategies that are not supported by the member firm. Accordingly, to properly supervise such activities, firms need to develop expertise in such products and strategies, which is simply not feasible for small firms, nor would it be a good use of their supervisory resources. Moreover, IAs have their own privacy obligations to their clients and may not be able to share information regarding their clients with unaffiliated member firms even if they are inclined to do so.

8. Under paragraph (b)(4), if a member approves a person's participation in a proposed activity that would require, if not for the person's association with a member, registration as a broker or dealer under the Exchange Act, the activity is deemed to be the member's business and the member must supervise accordingly.

a. Is registration under the Exchange Act the appropriate trigger for this provision?

b. Should paragraph (b)(4) be expanded to require a member to supervise a registered person's sale of securities through an entity that is not required to register under the Exchange Act?

c. When the registered person is associated with more than one member, the proposed rule allows members to develop a formal allocation arrangement whereby at least one member has the regulatory responsibility, including the supervision and recordkeeping of the proposed outside business activity. Are there any competitive effects of such allocation arrangements? Does this flexibility potentially create a disadvantage for some firms regarding how the costs are allocated? Should FINRA consider any other approaches?

As discussed above in response to Questions 1 and 6, NSCP suggests that FINRA consider whether receipt of transaction-based compensation, but only in connection with a securities transaction, might be simpler and as effective as conditioning the supervisory obligations under paragraph (b)(4) of the proposed rule on broker-dealer registration requirements.

NSCP did not receive any comments in favor of expanding paragraph (b)(4) of the proposed rule to require a member firm to supervise a registered person's sale of securities through an entity that is not required to register under the Exchange Act. Supervising activities that are conducted through another entity can be difficult as the member firm may not have the experience necessary to formulate an effective plan of supervision particularly as applied to products or services that the member firm does not offer. Moreover, effective supervision will likely require the active cooperation of an entity that is not under the member firm's control,

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which cooperation, although initially promised, may not always be forthcoming. As a result, it can be expected that most member firms would prohibit activities requiring supervision rather than take on the burden of supervision and the risk of supervisory failure.

NSCP did not receive any comments disagreeing with the provisions of the Proposal that allow member firms to enter into formal allocation arrangements where a registered person who engages in outside business activities is associated with two, or more, member firms. To the contrary, NSCP members commented that allocating the supervision of the outside brokerage activity among member firms offers a common sense and efficient approach to the supervision of brokerage activities by registered persons who are associated with more than one member firm. This approach permits firms to focus on their own business models and allocate their supervisory and compliance resources to their particular businesses. Supervising activity conducted through other firms would also raise the same type of concerns as are addressed in response to Questions 7 and 8. In order to make this allocation arrangement more useful to FINRA members, NSCP also suggests that, in light of possible concerns regarding whether a member firm might have an obligation to diligence its "outsourcing" of its supervisory obligation to another member firm, FINRA provide guidance that no such obligation attaches to an allocation of responsibilities under paragraph (b)(4).

9. Are there any material economic impacts, including costs and benefits, to investors, issuers and firms that are associated specifically with the proposal? If so:

a. What are these economic impacts and what are their primary sources?

b. To what extent would these economic impacts differ by business attributes, such as size of firm or differences in business models?

c. What would be the magnitude of these impacts, including costs and benefits?

NSCP members did not comment on the economic impact of the Proposal other than to indicate that, in general, as opposed to the current rules, it offers a simpler and more streamlined compliance process for covered persons and members firms, which, in turn, should have a positive economic impact on FINRA members. NSCP members from small firms expressed particular enthusiasm for aspects of the proposed rule that eliminate or streamline the responsibilities of firms over activities that occur away from the firm's oversight. Current rules dilute the resources available for supervisory and compliance personnel to monitor the business activities of the member firms because they are required to constantly monitor activity away from them as well. Similarly, NSCP members commented that the Proposal's exclusion from its scope of activities conducted on behalf of affiliates as well as the limited situations in which the Proposal would impose supervisory, recordkeeping and other obligations upon member firms in connection with outside business activities should significantly reduce compliance burdens on member firms as opposed to the current rules.

10. Are there any expected economic impacts associated with the proposal not discussed in this Notice? What are they and what are the estimates of those impacts?

NSCP members did not identify any additional economic impacts associated with the Proposal. [3]

[3] Although not specifically requested by the Proposal, NSCP has noted herein a number of areas on which regulatory guidance in addition to the rule would be helpful. We hope that in connection with any final rule,

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We commend FINRA for giving us this opportunity to present our views on FINRA's Proposal to address the outside business activities of registered persons. NSCP would welcome the opportunity to answer any follow-up questions that FINRA may have regarding this submission or to provide such further assistance as FINRA may request.

Thank you for your attention to these comments. Questions regarding the foregoing should be directed to the undersigned at (860) 672-0843.

Sincerely,

Lisa D. Crossley
Executive Director | NSCP
The National Society of Compliance Professionals
22 Kent Road | Cornwall Bridge, CT 06754
Phone: 860-672-0843 | Fax: 860-672-3005
lisa@nscp.org | www.nscp.org

cc: James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel
Meredith Cordisco, Associate General Counsel, Office of General Counsel
Jonathan S. Sokobin, Chief Economist, Office of the Chief Economist

FINRA will also release such guidance so that the regulatory expectations of registered representatives and member firms are clear.