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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-89218; File No. SR-FINRA-2020-020]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 3241 (Registered Person Being Named a Customer’s Beneficiary or Holding a Position of Trust for a Customer)

July 2, 2020.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 23, 2020, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt FINRA Rule 3241 (Registered Person Being Named a Customer’s Beneficiary or Holding a Position of Trust for a Customer).

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background

Investment professionals, including registered persons of member firms, face potential conflicts of interest when they are named a customer's beneficiary, executor, or trustee or holding a power of attorney or a similar position for or on behalf of their customer. These conflicts of interest can take many forms and can include a registered person benefiting from the use of undue and inappropriate influence over important financial decisions to the detriment of a customer. Moreover, problematic arrangements may not become known to the member firm or customer's other beneficiaries or surviving family members for years. Senior investors who are isolated or suffering from cognitive decline are particularly vulnerable to harm.³

Many, but not all, member firms address these conflicts by prohibiting or imposing limitations on their investment professionals, including registered persons, being named as a beneficiary or to a position of trust when there is not a familial relationship.⁴ Even where a member firm has policies and procedures, FINRA has observed situations where registered

³ See, e.g., SEC Office of the Investor Advocate, Elder Financial Exploitation White Paper (June 2018) and International Organization of Securities Commissions (IOSCO) Senior Investor Vulnerability Final Report (March 2018) (noting that senior investors are more vulnerable to financial exploitation due to social isolation, cognitive decline and other factors).

⁴ See Report on the FINRA Securities Helpline for Seniors (December 2015) and Report on FINRA Examination Findings (December 2018) (both discussing member firm policies observed by FINRA staff).

representatives have tried to circumvent firm policies and procedures, such as resigning as a customer's registered representative, transferring the customer to another registered representative, or having the customer name the registered representative's spouse or child as the customer's beneficiary.⁵

FINRA has taken steps to address misconduct in this area, including:

- (1) Identifying effective practices for member firms;⁶
- (2) Setting as an examination priority member firms' supervision of accounts where a registered representative is named a beneficiary, executor, or trustee or holds a power of attorney or a similar position for or on behalf of a customer who is not a family member;⁷
- (3) Reviewing customer complaints received directly by FINRA and those reported by member firms pursuant to FINRA Rule 4530 (Reporting Requirements) or Form U4 (Uniform Application for Securities Industry Registration or Transfer);
- (4) Reviewing regulatory filings made by firms on Form U5 (Uniform Termination Notice for Securities Industry Registration related to terminations for cause) disclosing related issues;
- (5) Reviewing matters referred by an arbitrator to FINRA for disciplinary investigation; and

⁵ Id. [sic].

⁶ Id. [sic].

⁷ See FINRA 2018 Regulatory and Examination Priorities Letter (January 2018), FINRA 2019 Risk Monitoring and Examination Priorities Letter (January 2019), and FINRA Risk Monitoring and Examination Priorities Letter (January 2020).

(6) Depending on the facts and circumstances of the conduct at issue, bringing actions for violations of FINRA rules, such as FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts), 3240 (Borrowing From or Lending to Customers) or 3270 (Outside Business Activities of Registered Persons).⁸

Proposed Rule Change

To further address potential conflicts of interest that can result in registered persons exploiting or taking advantage of being named beneficiaries or holding positions of trust for personal monetary gain, FINRA proposes adopting new Rule 3241 to create a uniform, national standard to govern registered persons holding positions of trust. This new national standard will better protect investors and provide consistency across member firms' policies and procedures.

Proposed Rule 3241 would provide that a registered person must decline:

- (1) Being named a beneficiary of a customer's estate⁹ or receiving a bequest from a customer's estate upon learning of such status unless the registered person provides written notice upon learning of such status and receives written approval from the

⁸ See, e.g., Robert Torcivia, Letter of Acceptance, Waiver and Consent, Case ID 2015044686701 (September 26, 2018) (finding, under the facts of the case, that the registered representative violated FINRA Rule 2010 in relation to accepting beneficiary designations and holding powers of attorney for senior customers and failing to inform the member firm of these positions).

⁹ For purposes of the proposed rule change, a customer's estate would include any cash and securities, real estate, insurance, trusts, annuities, business interests and other assets that the customer owns or has an interest in at the time of death. See proposed Supplementary Material .02 to Rule 3241. The proposed scope is consistent with includable property in a decedent's gross estate for federal tax purposes. See, e.g., IRS FAQs on Estate Taxes, available at <https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked-questions-on-estate-taxes#2>.

member firm prior to being named a beneficiary of a customer's estate or receiving a bequest from a customer's estate; and

- (2) Being named as an executor or trustee or holding a power of attorney or similar position for or on behalf of a customer unless:
- (a) Upon learning of such status, the registered person provides written notice and receives written approval from the member firm prior to acting in such capacity or receiving any fees, assets or other benefit in relation to acting in such capacity; and
 - (b) The registered person does not derive financial gain from acting in such capacity other than from fees or other charges that are reasonable and customary for acting in such capacity.¹⁰

The proposed rule change would not apply where the customer is a member of the registered person's immediate family.¹¹ The proposed rule change applies to customers who are not immediate family members because of the greater potential risk that the registered person has been named a beneficiary or to a position of trust by virtue of the broker-customer relationship. The proposed rule change also would not affect the applicability of other rules (e.g., FINRA Rule 2150 regarding improper use of customer securities or funds). If the proposed rule change is

¹⁰ See proposed Rule 3241(a). For example, receipt of a gift from a customer for acting as an executor or trustee or holding a power of attorney or similar position for or on behalf of the customer would be considered deriving financial gain from acting in such capacity.

¹¹ The proposed rule change would define "immediate family" to mean parents, grandparents, mother-in-law or father-in-law, spouse or domestic partner, brother or sister, brother-in-law or sister-in-law, son-in law or daughter-in-law, children, grandchildren, cousin, aunt or uncle, or niece or nephew, and any other person who resides in the same household as the registered person and the registered person financially supports, directly or indirectly, to a material extent. The term includes step and adoptive relationships. See proposed Rule 3241(c).

approved, FINRA would assess registered persons' and firms' conduct pursuant to Rule 3241 to determine the effectiveness of the rule in addressing potential conflicts of interest and evaluate whether additional rulemaking or other action is appropriate.

Knowledge

A registered person being named as a beneficiary or to a position of trust without his or her knowledge would not violate the proposed rule change; however, the registered person must act consistent with the proposed rule change upon learning that he or she was named as a beneficiary or to a position of trust. The proposed rule change would apply when the registered person learns of his or her status as a customer's beneficiary or a position of trust for or on behalf of a customer. A registered person may decline being named as a beneficiary or to a position of trust and decline receipt of any assets or other benefit from the customer's estate so as not to violate the proposed rule change. For example, if a customer named her registered person as her beneficiary without the beneficiary's knowledge, the proposed rule change would not apply and the registered person would not be in violation of the proposed rule change. However, when the registered person became aware of being so named (e.g., when the registered person is notified that he or she is to receive a bequest from the customer's estate), the requirements of the proposed rule change would apply and the registered person must act consistent with the proposed rule change (i.e., by declining the bequest unless he or she provides notice to and receives approval from the member firm).

Firm Notice and Approval

To provide flexibility to member firms, the proposed rule change does not prescribe any specific form of written notice and instead would permit a member firm to specify the required

form of written notice for its registered persons. Upon receipt of the written notice, the proposed rule change would require the member firm to:

- (1) Perform a reasonable assessment of the risks created by the registered person's assuming such status or acting in such capacity, including, but not limited to, an evaluation of whether it will interfere with or otherwise compromise the registered person's responsibilities to the customer;¹² and
- (2) Make a reasonable determination of whether to approve the registered person's assuming such status or acting in such capacity, to approve it subject to specific conditions or limitations, or to disapprove it.¹³

If a member firm approves the registered person's assuming such status or acting in such capacity, the member firm has supervisory responsibilities following approval. If the member firm imposes conditions or limitations on its approval, the member firm would be required to reasonably supervise the registered person's compliance with the conditions or limitations.¹⁴ Moreover, where a registered person is knowingly named a beneficiary, executor, or trustee or holds a power of attorney or a similar position for or on behalf of a customer account at the member firm with which the registered person is associated and the member firm has approved the registered person assuming such status or position, the member firm must supervise the account in accordance with FINRA Rule 3110 (Supervision), including the longstanding

¹² In the event that the customer is deceased when the registered person becomes aware that he or she was named the customer's beneficiary, FINRA would expect the member firm's reasonable assessment to include an evaluation of the registered person's relationship with the customer prior to the customer's death (e.g., any red flags of improper conduct by the registered person).

¹³ See proposed Rule 3241(b).

¹⁴ See proposed Rule 3241(b)(3).

obligation to follow-up on “red flags” indicating problematic activity. As to this latter point, with the notification and assessment of a registered person being named as a beneficiary or to a position of trust in relation to a customer account at the member firm, there is inherently more information from which red flags may surface. If a registered person is approved to hold (and receive compensation for) a position of trust for a customer away from the member firm, the requirements of both the proposed rule change and Rule 3270 regarding outside business activities would apply to the activities away from the firm.¹⁵

The proposed rule change would require a member firm to establish and maintain written procedures to comply with the rule’s requirements.¹⁶ The proposed rule change would also require member firms to preserve the written notice and approval for at least three years after the date that the beneficiary status or position of trust has terminated or the bequest received or for at least three years, whichever is earlier, after the registered person’s association with the firm has terminated.¹⁷ The proposed record retention requirement is similar to the requirement in Rule 3240.

Reasonable Assessment and Determination

¹⁵ There may be arrangements where a registered person holds a position of trust for a customer away from the firm but the requirements of Rule 3270 do not apply because the arrangement is not one of the listed positions in Rule 3270 (*i.e.*, an employee, independent contractor, sole proprietor, officer, director or partner of another person) or the registered person is not 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 member firm.

¹⁶ See proposed Rule 3241(b)(4).

¹⁷ See proposed Supplementary Material .03 to Rule 3241.

FINRA expects that a member firm's reasonable assessment of the risks created by the registered person's assuming such status or acting in such capacity would take into consideration several factors, such as:

- (1) Any potential conflicts of interest in the registered person being named a beneficiary or holding the position of trust;
- (2) The length and type of relationship between the customer and registered person;
- (3) The customer's age;
- (4) The size of any bequest relative to the size of a customer's estate;
- (5) Whether the registered representative has received other bequests or been named a beneficiary on other customer accounts.
- (6) Whether, based on the facts and circumstances observed in the member's business relationship with the customer, the customer has a mental or physical impairment that renders the customer unable to protect his or her own interests;
- (7) Any indicia of improper activity or conduct with respect to the customer or the customer's account (e.g., excessive trading); and
- (8) Any indicia of customer vulnerability or undue influence of the registered person over the customer.

This list is not intended to be an exhaustive list of factors that a member firm may consider as part of its assessment. Moreover, while a listed factor may not be applicable to a particular situation, the factors that a member firm considers should allow for a reasonable assessment of the associated risks so that the member firm can make a reasonable determination of whether to approve the registered person assuming a status or acting in a capacity.

For example, a registered person's request to hold a position of trust for an elderly customer who had no relationship with the representative prior to the initiation of the broker-customer relationship is likely to present different risks than a registered person's request to hold a position of trust for a longstanding friend. FINRA would not expect a registered person's assertion that a customer has no viable alternative person to be named a beneficiary or to serve in a position of trust to be dispositive in the member firm's assessment.

The proposed rule change would not prohibit a registered person being named a beneficiary of or receiving a bequest from a customer's estate. However, given the potential conflicts of interest, under the proposed rule change a member firm would need to carefully assess a registered person's request to be named a beneficiary of or receive a bequest from a customer's estate, and reasonably determine that the registered person assuming such status does not present a risk of financial exploitation (*e.g.*, a registered person receiving a bequest from a customer who has been a godparent since childhood or a customer who has been a friend since childhood) that the proposed rule is designed to address.

If possible, as part of the reasonable assessment of the risks, FINRA would expect a member firm to discuss the potential beneficiary status or position of trust with the customer as part of its reasonable determination of whether to approve the registered person assuming the status or acting in the capacity.

Scope of Proposed Rule

To address attempted circumvention of the restrictions (*e.g.*, by closing or transferring a customer's account), the proposed rule change would define "customer" to include any customer that has, or in the previous six months had, a securities account assigned to the registered person

at any member firm.¹⁸ Member firms have flexibility to reasonably design their supervisory systems to achieve compliance with the proposed rule change (*e.g.*, by using training, certifications or other measures). In addition, as discussed below, the proposed rule change would require the registered person, within 30 calendar days of becoming so associated, to provide notice to and receive approval from the member consistent with the rule to maintain the beneficiary status or position of trust.¹⁹

A registered person who does not have customer accounts assigned to him or her would not be subject to the proposed rule change. In addition, a registered person instructing or asking a customer to name another person to be a beneficiary of the customer’s estate or to receive a bequest from the customer’s estate would present similar conflict of interest concerns as the registered person being so named. Accordingly, the proposed rule change would not allow a registered person to instruct or ask a customer to name another person, such as the registered person’s spouse or child, to be a beneficiary of the customer’s estate or to receive a bequest from the customer’s estate.²⁰

Beneficiary Status and Positions of Trust Prior to Association with Member Firm

Registered persons move with some frequency between member firms. If a registered person was named as a beneficiary or to a position of trust prior to the registered person’s

¹⁸ See proposed Supplementary Material .01 to Rule 3241. A securities account would include, for example, a brokerage account, mutual fund account or variable insurance product account. For purposes of the proposed rule change, therefore, a registered person who is listed as the broker of record on a customer’s account application for an account held directly at a mutual fund or variable insurance product issuer would be subject to the proposed rule’s obligations (this is sometimes referred to as “check and application,” “application way,” or “direct application” business).

¹⁹ See proposed Supplementary Material .04 to Rule 3241.

²⁰ See proposed Supplementary Material .06 to Rule 3241.

association with the member firm, the proposed rule change would require the registered person, within 30 calendar days of becoming so associated, to provide notice to and receive approval from the member consistent with the rule to maintain the beneficiary status or position of trust.²¹

Pre-Existing Beneficiary Status and Positions of Trust

Potential conflicts of interest also exist when the beneficiary status or position of trust was entered into prior to the existence of a broker-customer relationship, such as where the customer was not a customer of the registered person at the time at which the registered person was named beneficiary or to a position of trust. These situations also have the potential that investment and other financial decisions will benefit the registered person as the customer's beneficiary or holder of a position of trust rather than the customer. Therefore, the proposed rule change would require the registered person and member firm to act consistent with the rule for any existing beneficiary status or position of trust prior to the initiation of the broker-customer relationship.²²

If the Commission approves the proposed rule change, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

²¹ See proposed Supplementary Material .04 to Rule 3241.

²² See proposed Supplementary Material .05 to Rule 3241. The proposed rule change would apply if the registered person is named a beneficiary or receives a bequest from a customer's estate after the effective date of the rule. For the non-beneficiary positions, the proposed rule change would apply to positions that the registered person was named to prior to the rule becoming effective only if the initiation of the broker-customer relationship was after the effective date of the proposed rule.

The proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

FINRA believes that the proposed rule change would result in minimal costs to member firms, while providing additional investor protections where such policies do not currently exist, are not consistently applied or are less restrictive than the proposed changes. The proposed rule change will ultimately benefit the investor community, and promote greater trust in the brokerage industry, by reducing the potential exploitation of vulnerable investors. FINRA believes that establishing an industry-wide benchmark for situations in which registered persons request member firm approval to be named beneficiaries or to positions of trust mitigate potential conflicts of interest consistently across the industry for all customers.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. All members would be subject to the proposed rule change.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet its regulatory objective.

Regulatory Need

FINRA is active in its efforts to protect senior and financially vulnerable investors from exploitation. In the context of these efforts, and with evidence of a growing trend of such exploitation, FINRA has recognized the potential conflict of interests that can arise from having a customer name their registered representative as a beneficiary or to a position of trust. To mitigate such conflicts of interest, as well as any potential resulting harm, FINRA is proposing adoption of Rule 3241.

Economic Baseline

The economic baseline for the proposed rule change is based on the existing firm policies and practices on beneficiary status and positions of trust, as well as the prevalence of registered persons being named in such capacity. To gauge the extent of both, FINRA has sought information with regard to current practices from a sample of member firms and trade associations. Specifically, FINRA sought information on current practices from firms represented on FINRA advisory committees and engaged trade associations in conversations. Information obtained indicates that the majority of firms have existing policies in place with respect to registered persons being named beneficiaries or to positions of trust.

The majority of member firms that participated in FINRA's outreach efforts indicated that they currently do not permit a registered person to be named a beneficiary for a customer who is not a family member, with some variations on how family relationship is defined. Firms indicated that they are more likely to allow registered persons to be named to positions of trust, in compliance with the firm's internal processes and procedures. Registered persons are typically required to request approval from the member firm to be named as a beneficiary or to a position of trust. Approval is usually requested through the outside business activities submission process. Monitoring of compliance with the procedures is conducted through the

member firms' various control functions including, for example, branch exams, annual questionnaire responses, and supervisory review of emails. FINRA understands, based on anecdotal information collected through its outreach efforts, that over the past five years more than 85% of such requests by registered persons have been on behalf of immediate family members.

Economic Impacts

FINRA believes that the economic impacts of the proposed rule change would result in minimal costs to member firms, while benefiting the investor community by providing additional investor protections where such policies do not currently exist, are not consistently applied or are less restrictive than the proposed changes.

The proposed rule change will ultimately benefit the investor community, and promote greater trust in the brokerage industry, by potentially reducing the exploitation of vulnerable investors. FINRA believes that establishing an industry-wide benchmark for situations in which registered persons request to be named beneficiaries or to positions of trust mitigate potential conflicts of interest consistently across the industry for all customers. As described above, such conflicts of interest can include, but are not limited to, a registered person benefiting from the use of undue and inappropriate influence over important financial decisions to the detriment of a customer.

Anecdotal information provided to FINRA indicates that most member firms that participated in the outreach efforts have in place both specific policies and procedures to manage requests for registered persons to act in a position of trust, as well as mechanisms to monitor compliance. FINRA believes that where member firms already have these types of policies and procedures in place, the costs of the proposed rule change should be low, mostly stemming from

compliance requirements. For example, FINRA observed some variation in firm policies regarding whether a registered person may be named a customer's beneficiary after transferring the customer account to another registered person. As this specific issue could result in circumvention of the regulatory intent of the proposed rule, FINRA is proposing to include a six-month look-back period with respect to the customer-registered person relationships. FINRA believes that this will provide some guardrails against attempts to circumvent the proposed rule, while imposing minimal costs on firms with respect to monitoring of transfers of accounts.

Member firms with different policies and procedures, whether more or less restrictive than proposed here, would likely incur costs to amend them. Those firms required to establish a higher standard for these activities may also incur new on-going supervisory costs. The same would be true for those member firms with no current policies or procedures covering these situations. Member firms with existing practices that are more restrictive than the proposed rule change could maintain those policies. However, member firms altering their current policies and procedures to be in alignment with the proposed rule change are expected to incur one-time costs to do so. Member firms will also incur some costs to provide training on the new requirements for registered persons.

FINRA recognizes that the proposed rule change can result in a diminishing of customer choice in identifying a person to serve in a capacity of trust. There may be circumstances where the registered person represents a better alternative to the customer than other available options. There may also be costs to a customer to amend estate or other legal documents if the member firm disapproves a registered person being named a beneficiary, executor, or trustee or holding a power of attorney or a similar position for or on behalf of the customer. Despite the potential loss of an appropriate person to serve in a capacity of trust or potential costs to a customer to

amend estate or other legal documents, FINRA believes that this cost is justified by the protections afforded to investors by significantly mitigating the particular conflict of interest.

FINRA recognizes that investment advisers, as well as other financial services professionals under different regulatory oversight, potentially have similar conflicts of interest with their customers when engaged in these activities. This is the case because the conflict of interest is not unique to the brokerage industry. Rather, the conflict arises from the pecuniary benefits that may accrue because of the nature of the relationship between the customer and the financial professional. However, there is no available information or data to permit FINRA to gauge the prevalence and impact of such relationships between these other financial professionals and their customers. Further, it is difficult to gauge the circumstances under which differences in the regulatory treatment of this activity would impact competition.

Alternatives Considered

FINRA considered various alternatives to the provisions in the proposed rule change. One alternative considered was prohibiting a registered person from inducing a customer to name the registered person as a beneficiary of the customer's estate. FINRA believes that the proposed rule change is a better approach for addressing potential conflicts of interest because of the inherent difficulty in proving inducement. Second, FINRA considered an outright prohibition of some or all positions of trust, but decided against that approach as some positions of trust, if properly known to and supervised by member firms, may benefit customers. Third, FINRA understands that member firms may have different approaches to defining family members in their current policies. FINRA considered different definitions of the term "immediate family," and ultimately based the definition in the proposed rule change on the definition in Rule 3240 with some changes to modernize the scope of covered persons and to

incorporate the requirement that the other person reside in the same household as the registered person. FINRA believes that this approach is appropriate given that member firms have the discretion to review and approve arrangements with customers who are not “immediate family” as defined in the proposed rule change, but may be considered family members in member firms’ current policies.

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in Regulatory Notice 19-36 (November 2019) (“Notice 19-36 Proposal”). FINRA received 17 comment letters in response to the Notice 19-36 Proposal. A copy of the Notice 19-36 Proposal is attached [sic] as Exhibit 2a. Copies of the comment letters received in response to the Notice 19-36 Proposal are attached [sic] as Exhibit 2c.²³

The comments and FINRA’s responses are set forth in detail below.

Support for the Notice 19-36 Proposal

Six commenters expressed support for the Notice 19-36 Proposal.²⁴ For example, ASA supported the proposed approach and stated that for most member firms, the Notice 19-36 Proposal would not fundamentally alter current practices or significantly increase the costs of compliance but would help crack down on those instances where unscrupulous actors within the industry try to exploit existing loopholes within the regulatory framework. FSI stated that the Notice 19-36 Proposal establishes clear parameters for member firms and financial professional to follow and appropriately allows member firms the flexibility to tailor the process to their unique business model.

²³ See Exhibit 2b for a list of abbreviations assigned to commenters.

²⁴ See ASA, FSI, Mack, PIABA, SIFMA and St. John’s Clinic.

While supporting the Notice 19-36 Proposal, the St. John's Clinic suggested also requiring member firms to disclose more information about a broker's employment status and reason for termination than would otherwise be available on BrokerCheck as a registered person may obtain a position of trust shortly after being terminated by a member firm. Mack also supported the Notice 19-36 Proposal and suggested requiring additional supervision and a surprise audit requirement when a registered person has been approved to hold a position of trust for a customer. Requirements related to disclosing more information about a registered person's employment status and reasons for termination than would otherwise be available on BrokerCheck are beyond the scope of the proposed rule change. If the proposed rule change is approved, FINRA would assess registered persons' and firms' conduct pursuant to the rule to determine the effectiveness of the rule in addressing potential conflicts of interest and evaluate whether additional rulemaking or other action is appropriate.

Four additional commenters expressed support for some aspects of the Notice 19-36 Proposal but suggested material changes to the Notice 19-36 Proposal.²⁵ Bolton supported the Notice 19-36 Proposal's addressing a registered person being named a customer's beneficiary, but suggested that holding positions of trust could be addressed under the outside business activity framework in existing FINRA rules.

The proposed rule change's requirement that a registered person provide notice to and receive approval from the member with which he or she is associated is similar to the requirements for notice and approval of outside business activities in Rule 3270. Pursuant to Rule 3270, no registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be compensated from any other person as a

²⁵ See Bolton, Cambridge, Fitapelli and Silver Law.

result of any business activity away from the member firm, unless he or she has provided prior written notice to the member.²⁶ The proposed rule would apply where a registered person is named to a position of trust for a customer of the member firm. If a registered person is approved to hold (and receive compensation for) a position of trust for a customer away from the member firm, the requirements of both the proposed rule change and Rule 3270 would apply to the activities away from the firm.²⁷

Fitapelli and Silver Law supported rulemaking in this area, but stated that a registered person should not be permitted to be a beneficiary of or hold a position of trust for a customer who is not an immediate family member. Fitapelli also suggested requiring member firm notification and approval for situations involving a registered representative's dealings with immediate family members.

The proposed rule change applies to customers who are not immediate family members because of the greater potential risk that the registered person has been named a beneficiary or to a position of trust by virtue of the broker-customer relationship. Recognizing that a registered person and customer may have a close and longstanding friendship or relationship that may be akin to, but not actually, a familial relationship, the proposed rule change would not prohibit a registered person being named a beneficiary of or receiving a bequest from a customer's estate. However, given the potential conflicts of interest that can result in registered persons exploiting or taking advantage of being named beneficiaries or holding positions of trust for personal

²⁶ FINRA is separately conducting a retrospective review of FINRA's rules governing outside business activities and private securities transactions, Rule 3270 and FINRA Rule 3280 (Private Securities Transactions of an Associated Person), respectively. See Regulatory Notice 18-08 (Outside Business Activities).

²⁷ FINRA also reminds members of registered persons' separate reporting obligations for Form U4, including Form U4 section 13, Other Business.

monetary gain, In assessing a registered person's request to be named a beneficiary of or receive a bequest from a customer's estate, FINRA would expect approval to be given only when the member firm has made a reasonable determination that the registered person being named a beneficiary or receiving a bequest from a customer does not present a risk of financial exploitation that the proposed rule change is designed to address. A member firm may choose to go beyond the proposed rule change to: (1) require notification and approval when a registered person is named a beneficiary or named to a position of trust for immediate family members; (2) further limit or prohibit registered persons from being named a customer's beneficiary or to a position of trust for a customer; or (3) impose additional obligations on the registered person when he or she is named a beneficiary or to a position of trust for a customer.

Cambridge agreed with many aspects of the Notice 19-36 Proposal but suggested some modifications. Cambridge stated that a mandatory rejection of the customer designating the registered person as a beneficiary could result in a scenario where the customer's intended designation would fail in its entirety and instead proposed adoption of a presumption in favor of the validity of the nomination unless and until, based on a subsequent review, the member firm determines that the nomination should not be honored.

Given the potential conflicts of interest, FINRA would expect a member firm to employ heightened scrutiny in assessing a registered person's request to be named a beneficiary of or receive a bequest from a customer's estate. Moreover, given the potential conflicts of interest, FINRA does not agree that a beneficiary designation should be presumed valid and free of potential conflicts of interest.

Cambridge also suggested that, because executorships may be subject to judicial review and often pertain to the customer's posthumous estate, the inclusion of executorships in the

Notice 19-36 Proposal is unnecessary. However, n executorship may provide a registered person with significant control over a customer's finances and, consequently, may present significant conflicts of interest. As such, including executorships among the positions of trust that are covered by the proposed rule change is appropriate.

Opposition to the Notice 19-36 Proposal

An anonymous commenter did not support the Notice 19-36 Proposal because it may limit customer choice where a customer does not have another person to be named his or her beneficiary. FINRA has observed that investment professionals, including registered persons, often develop close and trusted relationships with their customers, which in some instances have resulted in the investment professional being named the customer's beneficiary. However, being a customer's beneficiary may present significant conflicts of interest. FINRA would not expect a registered person's assertion that a customer has no viable alternative person to be named a beneficiary or to serve in a position of trust to be dispositive in the member firm's assessment.

Kaplon did not support the Notice 19-36 Proposal and suggested instead that member firm procedures are sufficient to address potential conflicts of interest. FINRA has observed that many, but not all, member firms address these potential conflicts by prohibiting or imposing limitations on being named as a beneficiary or to a position of trust when there is not a familial relationship. Even where a member firm has policies and procedures, FINRA has observed situations where registered representatives have tried to circumvent firm policies and procedures, such as resigning as a customer's registered representative, transferring the customer to another registered representative, or having the customer name the registered representative's spouse or child as the customer's beneficiary.

NASAA suggested that registered persons, their family members and any entities controlled by the registered persons should be prohibited from being named as a beneficiary or appointed to a position of trust by a customer unless the customer is an immediate family member. Moreover, NASAA suggested that even if the Notice 19-36 Proposal was limited to immediate family members, the registered person should be required to seek prior written authorization from the member firm and the member firm should be required to implement heightened supervision of the accounts. NASAA further suggested that if FINRA proceeds with allowing registered persons to be named as beneficiaries or serve in positions of trust for customers beyond their immediate family members, FINRA should, at a minimum, require the member firm to implement heightened supervision of these accounts and should explicitly state that member firms may choose to limit or prohibit registered persons to be named as a beneficiary or serve in positions of trust.

As stated in Notice 19-36, FINRA considered an outright prohibition of some or all positions of trust, but decided against that approach as some positions of trust, if properly known to and supervised by member firms, may benefit customers. For example, assuming that the member firm has done a reasonable assessment of the potential conflicts of interest before making a reasonable determination to approve the arrangement, a registered person with financial acumen and knowledge of a customer's financial circumstances may be better positioned to serve in a position of trust than other alternatives available to the customer.

As discussed above, the proposed rule change applies to customers who are not immediate family member because of the greater potential risk that the registered person has been named a beneficiary or to a position of trust by virtue of the broker-customer relationship. The risk that a registered person misused his or her role in the broker-customer relationship to be

named a beneficiary or hold a position of trust is reduced when the customer is an immediate family member.

As discussed in Item II supra, a member firm has supervisory obligations regarding any status or arrangement that is approved by the member firm. If the member firm imposes conditions or limitations on its approval, the member firm would be required to reasonably supervise the registered person's compliance with the conditions or limitations.²⁸ Moreover, where a registered person is named a beneficiary, executor, or trustee or holds a power of attorney or a similar position for or on behalf of a customer account at the member firm with which the registered person is associated, the member firm must supervise the account in accordance with FINRA Rule 3110 (Supervision), including the longstanding obligation to follow-up on "red flags" indicating problematic activity. As to this latter point, with the notification and assessment of a registered person being named as a beneficiary or to a position of trust in relation to a customer account at the member firm, there is inherently more information from which red flags may surface. If a registered person is approved to hold (and receive compensation for) a position of trust for a customer away from the member firm, the requirements of both the proposed rule change and Rule 3270 regarding outside business activities would apply to the activities away from the firm.

As noted above, a member may choose to go beyond the proposed rule change to: (1) require notification and approval when a registered person is named a beneficiary or named to a position of trust for immediate family members; (2) further limit or prohibit registered persons from being named a customer's beneficiary or to a position of trust for a customer; or (3) impose

²⁸ See proposed Rule 3241(b)(3).

additional obligations on the registered person when he or she is named a beneficiary or to a position of trust for a customer.

Knowledge

FSI and SIFMA agreed with the Notice 19-36 Proposal's approach to apply the proposed requirements only after the registered person has knowledge that he or she was named as a beneficiary or to a position of trust. Cole expressed general support for the Notice 19-36 Proposal but stated that a member firm should not be liable if the customer does not share his or her estate documents with the firm. Duran expressed concern about adopting a rule that would apply where the customer did not share his or her estate documents naming the registered person as a beneficiary and the registered person did not have control over the customer's action.

As discussed in Item II supra, a registered person being named as a beneficiary or to a position of trust without his or her knowledge would not violate the proposed rule change; however, the registered person must act consistent with the proposed rule change upon learning that he or she was named as a beneficiary or to a position of trust. The proposed rule change would apply when the registered person learns of his or her status as a customer's beneficiary or a position of trust for or on behalf of a customer. A registered person may: (1) provide notice to and receive approval from the member firm with which he or she is associated consistent with the proposed rule change; or (2) decline being named as a beneficiary or to a position of trust and decline receipt of any assets or other benefit from the customer's estate so as not to violate the proposed rule change.

Firm Notice and Approval

NASAA supported requiring a specific form of written notice for use by a registered person in requesting approval from the member firm with which he or she is associated. Absent

a specific form, NASAA suggested providing guidance regarding the information the registered person should provide to the member firm. FINRA proposes to provide member firms with flexibility in what form of written notice is required pursuant to the proposed rule change and, consequently, no specific form of written notice would be required by the proposed rule change. Because the proposed rule change requires each member firm to perform a reasonable assessment and make a determination of whether to approve or disapprove the status or arrangement, a member firm should obtain through the written notice or subsequent communications with the registered person or customer information sufficient upon which to perform the required assessment and make the related determination.

Reasonable Assessment and Determination

Cambridge requested clarification that the factors listed in Regulatory Notice 19-36 are not mandatory considerations as part of a member firm's assessment of whether to approve a position or arrangement. FINRA expects that a member firm's assessment would take into consideration several factors, such as the non-exhaustive list of factors provided in Regulatory Notice 19-36. While a factor may not be applicable to a particular situation, the factors considered by the member firm should allow for a reasonable assessment of the associated risks so that the member firm can make a reasonable determination of whether to approve the registered person assuming a status or acting in a capacity.

Cambridge also stated that it is neither appropriate nor reasonable to obligate a member firm to determine whether a customer suffers from an impairment as part of this assessment. In making the reasonable assessment and determination, a member firm is not required to seek to obtain a customer's medical information or make a medical determination related to a customer. However, a member firm may become aware of information related to the customer's physical or

mental impairment as part of the member firm’s business relationship with the customer (e.g., the customer may indicate to the firm that she was diagnosed with dementia). In these circumstances, FINRA expects that a member firm would take into consideration a customer’s known mental or physical impairment that renders the individual unable to protect his or her own interests (e.g., if the member firm is aware that the customer was diagnosed with dementia before naming the registered person as her beneficiary).

“Customer” Definition

To address attempted circumvention of the restrictions (e.g., by closing or transferring a customer’s account), the proposed rule change would define “customer” to include any customer that has, or in the previous six months had, a securities account assigned to the registered person at any member firm. Commenters had differing views on the inclusion of a six-month look-back period in the proposed “customer” definition. Cambridge requested eliminating the phrase “or in the previous six months” from the proposed definition of “customer” because inclusion of the look-back period denies the member firm flexibility in accommodating fact-specific circumstances. NASAA, on the other hand, suggested that the proposed “customer” definition be amended to include a 12-month look-back provision to prevent circumvention of the restrictions.

The inclusion of the look-back period is important in addressing potential conflicts of interest and circumvention of the proposed rule change. FINRA believes the six-month period strikes an appropriate balance between achieving the regulatory objective of addressing circumvention of the proposed rule change by transferring the customer account to another registered person and imposing reasonable requirements on member firms in tracking account transfers.

“Immediate Family” Definition

Fitapelli suggested revising the definition of “immediate family” that was included in the Notice 19-36 Proposal to exclude the phrase “any other person whom the registered person financially supports, directly or indirectly, to a material extent” due to ambiguity and being outside of the conventional definition of “immediate family.” NASAA suggested revising the phrase to require that any person who the registered person financially supports must also reside in the same household as the registered person.

In the proposed rule change, FINRA revised the relevant phrase in the proposed definition of “immediate family” to state “and any other person who resides in the same household as the registered person and the registered person financially supports, directly or indirectly, to a material extent.” For example, the phrase as revised would apply to a foster child who resides with and is financially supported by the registered person but who has not yet been legally adopted. The incorporation of the requirement that the other person reside in the same household as the registered person and receive material financial support from the registered person focuses the scope of the proposed “immediate family” definition.

For purposes of the proposed definition of “immediate family,” FSI suggested that a “cousin” mean only first cousins rather than second or more distant cousins. FINRA would interpret cousin in the “immediate family” definition to mean first cousins and not second or more distant cousins.

Scope

Kendrick questioned how the Notice 19-36 Proposal would apply to attorneys who hold securities licenses. The proposed rule change would apply to registered persons who have “customers” as defined by the proposed rule change (i.e., any customer that has, or in the previous six months had, a securities account assigned to the registered person at any member firm). A registered person also being licensed in another capacity (e.g., a state-licensed attorney) does not exempt the registered person from compliance with the proposed rule change. The proposed rule change would be triggered when the registered person is named a customer’s beneficiary or receives a bequest from a customer or is named a customer’s executor, trustee or holder of a power of attorney or similar position for a trustee. The proposed rule change would not be triggered when an individual who is not a “customer” so names a registered person. For example, a person may be registered with a member firm and hold a state law license. In this example, the proposed rule change would not be triggered when an individual who is not a “customer” under the rule names the registered person as the executor of the individual’s estate.

SIFMA requested clarification that the Notice 19-36 Proposal applies only when the registered person services the account or is the broker of record for the account and does not apply when a registered person is named as a beneficiary or to a position of trust for any client of the member firm. The proposed rule change would apply to registered persons who have “customers” as defined by the proposed rule change. The proposed rule change would not be triggered when an individual who is not a “customer” (e.g., a client of the member firm who has not had a securities account assigned to the registered person in the last six months) so names a registered person.

Because some member firms have trust lines of business, SIFMA requested clarification that the Notice 19-36 Proposal is not intended to cover member firms acting in their capacity as a

trustee in their trust lines of business. SIFMA stated its assumption that FINRA is focusing on individual registered persons who would be put in a position of trust in their personal capacity, not as a result of a member firm's authorized and approved business capacity.

A registered person may have a role or provide assistance where a member firm or affiliated entity offers a trust line of business. However, FINRA understands that a customer typically names the member firm or an affiliated entity—not a registered person—as trustee when the member firm or its affiliated entity offers a trust line of business. The proposed rule change would not apply where the customer names either the member firm or an affiliated entity as his or her trustee. However, the proposed rule change would apply where the customer names the individual registered person as his or her trustee.

In addition, a dually-registered representative may hold a power of attorney for a customer's discretionary investment advisory account. This power of attorney is intended to allow the investment adviser representative to manage the investment advisory account. The proposed rule change is not intended to address or impact a dually-registered representative holding a power of attorney or other similar instrument in order to manage a customer's investment advisory account.

NASAA stated that member firms should be required to advise customers in the account application of the applicable restrictions on the registered person being named a beneficiary or holding a position of trust for the customer. While a member firm may include information about the applicable restrictions in the account application, FINRA believes that a conversation or another communication between the customer and the registered person or another associated person of the member firm can also be effective in addressing the potential conflicts of interest,

restrictions imposed by the proposed rule change and any additional restrictions imposed by the member firm's procedures.

Naming Other Persons

Singer suggested that proposed Supplementary Material .06 applying the proposed rule change where the registered person instructs or asks a customer to name a third-party as the customer's beneficiary may not be sufficiently broad because: (1) the registered person could suggest or imply that the customer should name the third-party without instructing or asking; or (2) the third-party (e.g., the registered person's spouse) could communicate with the customer to avoid triggering the rule.

Proposed Supplementary Material .06 is intended to cover situations where the registered person attempts to circumvent the proposed rule change's restrictions. In these situations, the registered person may communicate with the customer in a manner where the registered person will seek to deny instructing or asking the customer to act and instead argue that the customer acted on his own volition (e.g., by having a third-party communicate with the customer). FINRA would interpret proposed Supplementary Material .06 broadly to cover these situations. For example, FINRA would interpret proposed Supplementary Material .06 to apply to situations where: (1) the registered person suggests or implies that the customer name another person, such as the registered person's spouse or child, to be a beneficiary of the customer's estate or to receive a bequest from the customer's estate; or (2) the registered person's spouse or another third party acts on behalf of the registered person to communicate with the customer in an effort to avoid triggering the proposed rule change's requirements.

Pre-Existing Beneficiary Status and Positions of Trust

SIFMA asked for clarification about how the Notice 19-36 Proposal would apply to beneficiary designations and positions of trust that are currently in place. SIFMA stated that while many member firms currently have policies in this area, it would be challenging and time-consuming to conduct a full-scale retroactive review of all accounts across an organization to determine whether the arrangements currently in place are consistent with the proposed requirements. NASAA, on the other hand, does not support a “grandfathering” clause for beneficiary designations and positions of trust that are currently in place. Moreover, NASAA suggested that member firms should ask about the existence of any pre-existing position during the hiring process so that the relationship can be screened before the individual associates with the member firm.

Many, but not all, member firms currently have policies and procedures in place to address potential conflicts by prohibiting or imposing limitations on being named as a beneficiary or to a position of trust when there is not a familial relationship. Accordingly, member firms may have approved arrangements under the policies and procedures in place prior to the proposed rule change becoming effective. The proposed rule would apply if the registered person is named a beneficiary or receives a bequest from a customer’s estate after the effective date of the rule. For the non-beneficiary positions, the proposed rule would apply to positions that the registered person was named to prior to the rule becoming effective only if the initiation of the broker-customer relationship was after the effective date of the proposed rule.

For example, a registered representative was named a beneficiary of a customer who is not an immediate family member in 2018, consistent with the firm’s procedures, and the customer passes away after the proposed rule change becomes effective. The registered

representative is notified by the executor that he is to receive a bequest of \$5,000 from the customer's estate. Because the bequest would be received after the proposed rule change is effective, the registered representative would be required to provide written notice to the member firm and the member firm would be required to perform a reasonable assessment and determination of whether to approve or disapprove the registered representative receiving the bequest.

If a registered person was named as a beneficiary or to a position of trust prior to the registered person's association with the member firm, proposed Supplementary Material .04 would require the registered person, within 30 calendar days of becoming so associated, to provide notice to and receive approval from the member consistent with the rule to maintain the beneficiary status or position of trust. If a registered person was named to a position of trust prior to the proposed rule change becoming effective, proposed Supplementary Material .04 would apply if the registered person moved to a new member firm after the proposed rule change became effective.

For example, a registered representative was named a trustee by a customer who is not an immediate family member in 2018, consistent with Member Firm A's procedures. Notice to and approval by Member Firm A is not required in order for the registered representative to continue serving as the customer's trustee after the proposed rule change becomes effective. However, if the registered representative left Member Firm A to become associated with Member Firm B after the proposed rule change became effective, proposed Supplementary Material .04 would apply and the registered representative would need to provide notice to and receive approval from Member Firm B in order to continue serving in the position.

Application beyond Broker-Dealers

Singer stated that “FINRA’s best intentions can only be extended so far” and that state and federal laws may need to be revised to address the consequences of financial professionals taking advantage of elderly or vulnerable customers. FINRA welcomes the opportunity to work with other regulators to address misconduct in this area.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2020-020 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2020-020. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2020-020 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁹

J. Matthew DeLesDernier,
Assistant Secretary.

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²⁹ 17 CFR 200.30-3(a)(12).