



This document is scheduled to be published in the Federal Register on 10/14/2020 and available online at federalregister.gov/d/2020-22636, and on govinfo.gov

8011-01p

SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-90116; File No. SR-FINRA-2020-020]

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

October 7, 2020.

I. Introduction

On June 23, 2020, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² 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). The proposed rule was published for comment in the Federal Register on July 9, 2020.³ On August 18, 2020, FINRA consented to an extension of the time period in which the Commission must approve the proposed rule, disapprove the proposed rule, or institute proceedings to determine whether to approve or disapprove the proposed rule to October 7, 2020.⁴ On October 6, 2020, FINRA responded to the comment letters received in response to the Notice.⁵ This order approves the proposed rule.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 89218 (July 2, 2020), 85 FR 41249 (July 9, 2020) (File No. SR-FINRA-2020-020) (“Notice”).

⁴ See letter from Jeanette Wingler, Associate General Counsel, Office of General Counsel, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel, Division of Trading and Markets, Commission, dated August 18, 2020.

⁵ See letter from Jeanette Wingler, Associate General Counsel, Office of General Counsel, FINRA, to Vanessa Countryman, Secretary, Commission, dated October 6, 2020 (“FINRA Letter”). The FINRA Letter is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA, on the Commission’s website at

II. Description of the Proposed Rule

The proposed rule would address the conflicts of interest that result from registered representatives being named beneficiaries of a customer or holding positions of trust on behalf of a customer for personal monetary gain.⁶ Specifically, the proposed rule would require a registered representative to decline being named a beneficiary of a customer's estate or receiving a bequest from a customer's estate unless she notifies her employer in writing and receives written approval from the broker-dealer prior to being named a beneficiary of a customer's estate or receiving a bequest from a customer's estate.⁷ The proposed rule would also require a registered representative to decline being named as an executor or trustee or holding a power of attorney or similar position for or on behalf of a customer unless: (1) she provides written notice to her employer and receives written approval from the broker-dealer prior to acting in such capacity or receiving any fees, assets or other benefit in relation to acting in such capacity; and (2) she 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.⁸ The proposed rule would not apply where the customer⁹ is a member of the registered representative's immediate family.¹⁰

<https://www.sec.gov/comments/sr-finra-2020-020/srfinra2020020.htm>, and at the Commission's Public Reference Room.

⁶ Notice at 41250.

⁷ Id.

⁸ Id.

Registered Representative’s Knowledge

The proposed rule would require that a registered representative have knowledge that she was named as a beneficiary or to a position of trust. A registered representative who was named to such a capacity without her knowledge generally would not violate the new rule.¹¹ Similarly, a registered representative cannot evade the rule by instructing or asking a customer to name another person, such as the registered representative’s spouse or child, to be a beneficiary of the customer’s estate or to receive a bequest from the customer’s estate.¹²

Broker-Dealer Notice and Approval

As stated above, the proposed rule would require a registered representative to notify, and receive prior approval from, her employer if she is named as a beneficiary or to a position of trust by her customer. Similarly, if a registered representative was named as a beneficiary or to a

⁹ For purposes of the proposed rule, the word “customer” would include any customer that has, or in the previous six months had, a securities account assigned to the registered representative at any FINRA member broker-dealer. Notice at 41252.

¹⁰ Notice at 41250. FINRA stated that the risk that a registered representative misused 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. See Notice at 41255. Over the past five years, FINRA stated that more than 85% of such requests by registered representatives have been on behalf of immediate family members. See Notice at 41253.

For purposes of the proposed rule, the term “immediate family” would 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 representative who the registered representative financially supports, directly or indirectly, to a material extent. The term would also include step and adoptive relationships. Notice at 41250.

¹¹ Notice at 41251. As described further below, the registered representative with knowledge that she has been named to a position of trust or as a beneficiary to the customer’s estate would need to provide notice to her member broker-dealer and receive approval from the member broker-dealer before she may assume such status or act in such capacity.

¹² Notice at 41252.

position of trust prior to the registered representative's association with the FINRA member broker-dealer, the proposed rule would require her, within 30 calendar days of becoming associated, to provide notice to and receive approval from, the broker-dealer to maintain the beneficiary status or position of trust.¹³ Furthermore, if a registered representative was named as a beneficiary or to a position of trust prior to the registered representative establishing a customer relationship with the individual, the registered representative and her broker-dealer employer would need to comply with the proposed new rule.¹⁴

The proposed rule does not prescribe any specific form of written notice but instead would permit a FINRA member broker-dealer to specify the required form of written notice for its registered representatives.¹⁵ Upon receipt of the written notice, the proposed rule would require the broker-dealer to: (1) perform a reasonable assessment of the risks created by the registered representative's assuming such status or acting in such capacity, including, but not limited to, an evaluation of whether it would interfere with or otherwise compromise the registered representative's responsibilities to the customer; and (2) make a reasonable determination of whether to approve the registered representative's assuming such status or acting in such capacity, to approve it subject to specific conditions or limitations, or to disapprove it.¹⁶

If a FINRA member broker-dealer approves a registered representative assuming such status or acting in such capacity, the broker-dealer assumes supervisory responsibilities

¹³ Id.

¹⁴ Id.

¹⁵ Notice at 41251.

¹⁶ Id.

following approval.¹⁷ The proposed rule would require a member firm to establish and maintain written procedures to comply with the proposed new rule's requirements.¹⁸ The proposed rule also would require FINRA member broker-dealers 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 representative's association with the firm has terminated.¹⁹

Reasonable Assessment and Determination

The proposed rule would not prohibit a registered representative from being named a beneficiary of, or receiving a bequest from, a customer's estate. However, given the potential conflicts of interest such arrangements create, the proposed rule would require a FINRA member broker-dealer to reasonably assess the risks created by the registered representative's assuming such status or acting in such capacity, taking into consideration several factors, including, but not limited to: (1) any potential conflicts of interest created by the registered representative being named a beneficiary or holding a position of trust; (2) the length and type of relationship between

¹⁷ Id. If the FNRA member broker-dealer imposes conditions or limitations on its approval, the broker-dealer would be required to reasonably supervise the registered representative's compliance with the conditions or limitations. Moreover, where a registered representative 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 firm with which the registered representative is associated and the firm has approved the registered representative assuming such status or position, the firm must supervise the account in accordance with FINRA Rule 3110, including the longstanding obligation to follow-up on "red flags" indicating problematic activity. If a registered representative is approved to hold (and receive compensation for) a position of trust for a customer away from the FINRA member broker-dealer, the requirements of both the proposed rule and FINRA Rule 3270 regarding outside business activities would apply to the activities away from the firm. Notice at 41251.

¹⁸ Id.

¹⁹ Id.

the customer and registered representative; (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 broker-dealer’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; and (8) any indicia of customer vulnerability or undue influence of the registered representative over the customer.²⁰

Timing

The proposed rule would apply if the registered representative is named a beneficiary or receives a bequest from a customer’s estate after the effective date of the proposed new rule. For the non-beneficiary positions, the proposed rule would apply to positions that the registered representative was named to prior to the rule becoming effective only if the initiation of the customer relationship between the registered representative and the customer occurred after the effective date of the proposed rule.²¹

III. Discussion and Commission Findings

After careful review of the proposed rule, the comment letters, and FINRA’s responses to the comments, the Commission finds that the proposed rule is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national

²⁰ Notice at 41251. FINRA stated that while a listed factor may not be applicable to a particular situation, the factors that a FINRA member broker-dealer considers should allow for a reasonable assessment of the associated risks so that the firm can make a reasonable determination of whether to approve the registered representative’s assuming a status or acting in a capacity. *Id.*

²¹ Notice at 41252.

securities association.²² Specifically, the Commission finds that the proposed rule is consistent with Section 15A(b)(6) of the Exchange Act,²³ which requires, among other things, that FINRA rules 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's proposed rule aims to address concerns related to conflicts of interest created when registered representatives are named beneficiaries of a customer or hold positions of trust on behalf of a customer for personal monetary gain. FINRA stated that these conflicts of interest can take many forms and include a registered representative benefiting from the use of undue and inappropriate influence over important financial decisions to the detriment of a customer.²⁴ The proposed rule would establish a uniform, national standard that is designed to protect investors from registered representatives who might exploit their relationships with their customers. The proposed rule would also establish a consistent approach to addressing these concerns across FINRA member broker-dealers' policies and procedures.²⁵ The Commission believes that the proposed rule requiring a registered representative to notify her employer prior to entering into such relationships with her customers, as well as requiring the firm to approve and supervise the proposed relationship after reasonable analysis of the risks will lead to greater

²² In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²³ 15 U.S.C. 78o-3(b)(6).

²⁴ See Notice at 41250.

²⁵ The inconsistent approach among firms currently allows registered representatives to circumvent firms' policies and procedures, for example by 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. See id. The proposed rule change is intended to cover these situations. See Notice at 41257.

oversight of registered representatives' activities, thereby reducing the potential risk of customer harm.²⁶

Two commenters support the proposed rule, believing it will serve to protect investors and mitigate potential conflicts of interests that can arise from having a customer name their registered representative as a beneficiary or to a position of trust.²⁷ One commenter stated that the proposed rule would help promote trust and confidence in the securities industry by ensuring that broker-dealers establish appropriate policies that will protect their senior and vulnerable customers.²⁸ The second commenter viewed the proposed rule as “an important and necessary step in fighting a particular form of abuse – where registered representatives take advantage of customers to have themselves installed as the customers’ beneficiaries or trustees over the clients’ assets.”²⁹ However, the latter commenter also stated that further action was necessary. Specifically, the commenter recommended that FINRA adopt a uniform written notice rather than permitting broker-dealers specify the required form of written notice for their respective registered representatives. The commenter believes that this amendment to the proposed rule would add yet another procedural safeguard that would help protect investors.³⁰

²⁶ See letter from Samuel B. Edwards, President, Public Investors Advocate Bar Association, dated July 30, 2002 (“PIABA Letter”) (finding meaningful benefit in a firm having more information available when supervising transactions in an account for which the firm is on notice the registered representative has a financial interest).

²⁷ See letter from Lisa Bleier, Managing Director, Securities Industry and Financial Markets Association (“SIFMA”), to Matthew DeLesDernier, Assistant Secretary, Commission, dated July 30, 2020 (“SIFMA Letter”) and PIABA Letter.

²⁸ SIFMA Letter.

²⁹ PIABA Letter.

³⁰ Id.

As described in the Notice, FINRA considered adopting a uniform written notice for its member broker-dealers.³¹ FINRA decided, however, that it was important to provide its members with a level of flexibility that a uniform written notice could not give them.³² Because the proposed rule would require each broker-dealer to perform a reasonable assessment and make a determination of whether to approve or disapprove a proposed arrangement, FINRA believes it is important for each firm to decide for itself the type and amount of information needed to perform the required assessment and make the related determination.³³ Accordingly, FINRA declined to amend the proposed rule in response to the comment.

The Commission recognizes the possible costs to customers associated with the proposed rule (for example, less customer choice in identifying a person to serve in a capacity of trust).³⁴ The Commission also believes, however, that a customer may benefit if a registered representative's status as trustee or beneficiary are disclosed to the firm and the risks of undue influence are sufficiently mitigated. Moreover, the proposed rule does not prescribe any specific form of written notice, giving firms the flexibility to specify the required form of written notice for its registered representatives based on a firm's specific business model and resources.³⁵ Accordingly, the Commission believes that the proposed rule strikes a balance by allowing a

³¹ See FINRA Letter (stating that regardless of its format, the notice should provide a broker-dealer sufficient information about the proposed relationship upon which to perform the required assessment and make the related determination); see also Notice at 41256.

³² See FINRA Letter; see also Notice at 41256.

³³ Id.

³⁴ See Notice at 41253 and FINRA Letter. There may also be costs to a customer to amend estate or other legal documents if the broker-dealer disapproves a registered representative being named a beneficiary, executor, or trustee or holding a power of attorney or a similar position for or on behalf of the customer.

³⁵ See Notice at 41251.

firm to reasonably assess the risks to customers associated with those conflicts of interest and permitting a registered representative to be named a beneficiary of a customer or hold a position of trust on behalf of a customer for personal monetary gain if the firm reasonably determines the risks are acceptable. For these reasons, the Commission finds that the proposed rule will provide additional investor protections, especially for broker-dealers who do not currently have policies and procedures in place to address these scenarios, or have such policies and procedures that are either less restrictive than the proposed rule change or are applied inconsistently.³⁶

One commenter stated that it applauded FINRA for recognizing the need for controls in this area, but it maintained that registered persons should be unconditionally prohibited from being named as beneficiaries or appointed to positions of trust by any customer other than immediate family members.³⁷ In response, FINRA stated that it considered an outright prohibition of some or all positions of trust, but declined to adopt a prohibition, believing that some positions of trust may benefit customers³⁸ and the proposed rule would establish safeguards

³⁶ See Notice at 41252.

³⁷ See letter from Christopher Gerold, President, North American Securities Administrators Association, Inc., to J. Matthew DeLesDernier, Assistant Secretary, Commission, dated July 30, 2020 (“NASAA Letter”).

³⁸ FINRA stated that it 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. See Notice at 41251-2. However, according to FINRA, there may be circumstances where the registered representative represents a better alternative to the customer than other available options. Assuming a broker-dealer has done a reasonable assessment of the potential conflicts of interest before making a reasonable determination to approve the arrangement, a registered representative 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. See Notice at 41253, 41255-6.

to protect investors, including: requiring disclosure of the proposed relationship to the registered representative's employer broker-dealer, requiring the firm to assess the risks of the proposed arrangement, requiring the firm to affirmatively approve or deny the proposed arrangement, and reaffirming the firm's obligation to maintain records regarding, and supervise, the arrangement.³⁹

The Commission shares the commenter's concern that certain conflicts of interest create high-pressure situations for registered representatives to engage in conduct contrary to the best interest of their customer.⁴⁰ As stated above, however, the Commission also sees value for customers to be able to appoint their registered representatives to a position of trust if the risks can be properly mitigated. The Commission believes the proposed rule would help mitigate the risks by requiring a broker-dealer to reasonably assess a proposed relationship based on detailed disclosure of the relationship by the registered representative, and, based on its assessment, whether to approve or disapprove the proposed relationship, or approve the arrangement subject to additional conditions or limitations.⁴¹

A commenter also asked FINRA to apply the proposed rule to preexisting beneficiary designations or designated positions of trust. In particular, the commenter believes that more investors should benefit from the proposed rule's protections.⁴² In response, FINRA stated that many of its member broker-dealers already have policies and procedures prohibiting or imposing

³⁹ See FINRA Letter; see also Notice at 41254.

⁴⁰ See NASAA Letter.

⁴¹ Proposed Rule 3241(b). The Commission notes that the proposed rule represents the minimum a broker-dealer must do when a registered representative is named a beneficiary of a customer or holds a position of trust on behalf of a customer for personal monetary gain. The broker-dealer may choose to go beyond the proposed rule by: (1) requiring notification and approval when a registered person is named a beneficiary or to a position of trust for immediate family members; or (2) completely prohibiting the practice. See FINRA Letter.

⁴² See NASAA Letter.

limitations on being named as a beneficiary or to a position of trust when there is not a familial relationship. Accordingly, many preexisting beneficiary designations or positions of trust have already been addressed by their respective firms.⁴³ Moreover, FINRA believes that it would be challenging and time-consuming for broker-dealers to conduct a full-scale retroactive review of all accounts across an organization to determine whether the arrangements currently in place are consistent with the proposed requirements.⁴⁴ In addition, customers may have relied on a broker-dealer's approval of arrangements currently in place in drafting estate or other legal documents, handling their assets or performing some duties (e.g., a registered representative may have been named a customer's trustee in reliance on the firm's prior approval). As such, FINRA states that retroactively applying the obligations of the proposed rule would further compound the challenge for broker-dealers, registered representatives and customers.⁴⁵

The Commission acknowledges that if applied retroactively the proposed rule's protections could benefit more customers who designated their registered representative a beneficiary or to hold a position of trust. However, the Commission also acknowledges the resources (financial and time) firms would expend to retroactively apply the proposed rule to existing customers, as well as the potential disruption to customers who have relied on existing arrangements with their registered representatives. Accordingly, the Commission believes that it is appropriate only to apply the rule prospectively. To the extent a registered representative was named by a customer as a beneficiary or to a position of trust prior to the effective date of the

⁴³ See FINRA Letter and Notice at 41257.

⁴⁴ See FINRA Letter (citing a letter to FINRA commenting on Regulatory Notice 19-36 (November 2019) from the Securities Industry and Financial Markets Association, a United States industry trade group representing securities firms, banks, and asset management); see also Notice at 41257.

⁴⁵ See FINRA Letter.

proposed rule, if that registered representative takes a job with, and moves the customer's account to, a new broker-dealer following the effective date, she and her new firm would be subject to the proposed rule's obligations.

As stated above, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act.⁴⁶ The Commission believes that establishing a uniform, baseline standard will help broker-dealers protect their customers from those registered representatives who might exploit their relationships with their customers. Specifically, requiring a registered representative to notify her employer prior to being named a beneficiary of a customer or holding positions of trust on behalf of a customer for personal monetary gain, as well as requiring the firm to approve and supervise the proposed relationship after reasonable analysis of the risks, will lead to greater oversight of registered representatives' activities, thereby helping to mitigate the potential risk of customer harm.⁴⁷

IV. Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Exchange Act⁴⁸ that the proposed rule (SR-FINRA-2020-020) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁹

J. Matthew DeLesDernier,
Assistant Secretary.

⁴⁶ 15 U.S.C. 78o-3(b)(6).

⁴⁷ Further, FINRA stated that it would assess registered representatives' and broker-dealers' conduct under the rule to determine its effectiveness in addressing potential conflicts of interest and evaluate whether additional rulemaking or other action is appropriate. See Notice at 41254.

⁴⁸ 15 U.S.C. 78s(b)(2).

⁴⁹ 17 CFR 200.30-3(a)(12).

[FR Doc. 2020-22636 Filed: 10/13/2020 8:45 am; Publication Date: 10/14/2020]