

FINRA Conduct Rule 3270: Outside Business Activities of Registered Persons (the “OBA Rule”)

Analysis by Bill Singer, BrokeAndBroker.com Blog

Let's examine FINRA's *OBA Rule* and make sure that we understand what's required. Note my commentary after each section:

FINRA Conduct Rule 3270: Outside Business Activities of Registered Persons

No registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person,

Bill Singer's Comment: First and foremost, the FINRA OBA Rule only applies to registered persons. Secondly, compensation is of no consequence if you are engaged in the activities of an employee, independent contractor, sole proprietor, officer, director, or partner. That's a very important distinction: If you are uncompensated but serving in the roles set forth in the opening of the OBA Rule, then you still fall under the coverage of the rule.

or be compensated, or have the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm,

Bill Singer's Comment: Note that the "or" separates all of the previously cited specific roles in which you act from any role in which you are either compensated or have the "reasonable expectation of compensation." The regulatory graveyard is littered with the smart-ass bodies of registered folks who - wink, wink, nudge, nudge - thought that they had cleverly worked out an "understanding" with an outside party that we'll tell my brokerage firm that I'm not being paid but you and I have an understanding that once the firm gives me the compliance okay that you will start paying me. Also note that it's "any" outside business activity. Any as in any - that clear? OBA for which you are not:

- 1) serving in the role of an employee, independent contractor, sole proprietor, officer, director, or partner; and
- 2) going to be compensated or for which you have no reasonable expectation of compensation

is not covered under FINRA Rule 3270.

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unless he or she has provided prior written notice to the member, in such form as specified by the member.

Bill Singer's Comment: That all important term "unless" is what may constitute your compliance and regulatory safe harbor. The FINRA OBA Rule is written with a negative preamble, which clearly warns you that you cannot engage in any of the covered OBA unless you provide prior written notice to your firm. The type of notice is critical and must be provided before you engage in any restricted OBA. Second, you must provide the prior notice in a written form to your firm.

Could you send an email prior notice to your firm? Perhaps. Could you send a fax to your firm? Well, to the extent that anyone is still using faxes, maybe you could. Could you put down the proposed OBA terms on a cocktail napkin and pass that over to your boss? Give it a shot. On the other hand, the OBA Rule says that your prior written notice must be "in such form as specified by the member." If your firm has an OBA Notice form (which many do), then the only way that you may submit prior written notice (in order to fall under the protections of the OBA Rule) is via that prescribed in-house form.

Passive investments and activities subject to the requirements of Rule 3280 shall be exempted from this requirement.

Bill Singer's Comment: Not covered under FINRA Rule 3270 are so-called "passive investments." What's a passive investment? This is one aspect of the OBA Rule that I do not like. If a regulator offers an exemption from submitting prior written notice for something characterized as a "passive investments," then you would think that the regulator would have included a definition of that key term in the rule. In the absence of such guidance from FINRA, I urge you to make sure that any guidance you receive that asserts that a particular OBA is "passive" is archived in a manner that will allow you to easily reproduce it to a compliance officer or regulator. A sound practice would be to provide your firm with a copy of such written advice and confirm that you are correct in that threshold assumption.

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Critically, note that if you are engaging in a private securities transaction ("PST") as set forth in FINRA Rule 3280: Private Securities Transactions of an Associated Person, then such PST is exempted from coverage under the OBA Rule, however, not only should you ensure that you have fully complied with the PST Rule requirements but be careful that in addition to engaging in PST that you are not also engaged in OBA, which would require separate and distinct disclosure. READ: "FINRA Rule 3280 Private Securities Transactions Analysis By Bill Singer" (*BrokeAndBroker.com Blog*, December 30, 2016).

*****Supplemental Material*****

.01 Obligations of Member Receiving Notice. Upon receipt of a written notice under Rule 3270, a member shall consider whether the proposed activity will: (1) interfere with or otherwise compromise the registered person's responsibilities to the member and/or the member's customers or

Bill Singer's Comment: The first obligation that your FINRA member firm must discharge upon its receipt of your notice is to determine whether your proposed OBA will interfere or compromise your responsibilities to the firm and/or its customers. As you can imagine, that determination isn't always undertaken in an abundance of good faith. You get a hack of a compliance officer who prefers to say "NO" to everything and you may find your request shut down for no good reason. Be prepared to argue your case and, if necessary, take the request higher up - or, if office politics are such that it's best to keep your mouth shut and go away and lick your wounds, consider that option.

Never tell anyone asking you to engage in an OBA that it's merely a matter of your filing notice. Your firm may well have a punchlist of tasks to perform before giving its approval -- and that in-house review may strike you as demanding that you jump through a series of endless hoops. That being said, unlike the FINRA PST Rule, which requires both prior written notice and the conveyance from the member firm of its disapproval or approval, the FINRA OBA Rule

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only requires prior written notice as part of the registered person's regulatory obligation. Note that although *Supplementary Material .01 (1)* requires the member firm to consider your proposed OBA "upon receipt" of your written notice, that there is no proscribed period of time to do such.

(2) be viewed by customers or the public as part of the member's business based upon, among other factors, the nature of the proposed activity and the manner in which it will be offered.

Bill Singer's Comment: *Supplementary Material .01(2)* strikes me as bordering on asinine. I mean, seriously, how could a FINRA member firm really conclude that any OBA may not be "viewed" by its customers or the public as "part" of the firm's business? If you have any doubts about my view, just consider the fact that whenever there is any litigation about an OBA, the majority of public customers tend to assert that they thought the OBA was somehow sponsored or related to the member firm's business.

Based on the member's review of such factors, the member must evaluate the advisability of imposing specific conditions or limitations on a registered person's outside business activity, including where circumstances warrant, prohibiting the activity.

Bill Singer's Comment: After reviewing your proposed OBA, your firm may impose "specific conditions" upon your activity. After reviewing your proposed OBA, your firm may impose "limitations" upon your activity. Okay, you tell me, what's the difference between imposing plain-old "conditions" and "specific conditions?" And while you're pondering that purported distinction, let me know what the difference is between "specific conditions" and "limitations." Does anyone at FINRA ever read the organization's rules and ask what the hell they mean?

Finally, in another bit of poor drafting, the FINRA OBA Rule informs us that among the so-called conditions and limitations that a firm may impose is one of prohibition. Why do I say that the OBA Rule views a prohibition as a form of "specific conditions" or "limitations?"

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If you read the *Supplementary Material .01*, you will see that "prohibiting the activity" is described as included within the terms of "specific conditions" and "limitations." In my lexicon, I don't consider the prohibition to constitute a condition or limit - a prohibition is an alternative to a condition or limitation. It's what happens when there are no conditions or limitations and the member firm opts for a simple "NO."

A horrific flaw in the construction of the OBA Rule and the attached *Supplementary Material* is the absence of any deadline when the member firm must either set forth specific conditions, limitations, or prohibit the OBA. It's never actually a "proposed" OBA because the OBA Rule doesn't require the registered person to await any response from the member firm. As such, a registered person could notify a FINRA member firm in writing of an OBA; not hear back from the firm for, say, a month; engage in the OBA, and, months later, the member firm can convey its decision to condition, limit, or prohibit the activity. Keep in mind that I am not suggesting that a member firm or any business should abandon its proper legal rights to impose certain reasonable conditions or limits on the activities of its employees -- that sort of comes with the territory of a terminable-at-will employment relationship. On the other hand, for those of you who appreciate nuance, we are not talking about an in-house employment policy here. We are talking about a rule drafted by a Wall Street self-regulatory organization engaged in the regulation of its member firms.

A member also must evaluate the proposed activity to determine whether the activity properly is characterized as an outside business activity or whether it should be treated as an outside securities activity subject to the requirements of Rule 3280.

Bill Singer's Comment: FINRA has charged compliance officers with failing to identify what was presented to them as an OBA but the self-regulator deemed to be a PST. READ: "CCO Fined And Suspended For Missing Private Securities Transaction" (*BrokeAndBroker.com Blog*, June 14, 2016). Compliance staff should

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be meticulous in documenting for the file what was asked, what was answered, and what was provided during this review. READ: "FINRA Rule 3280 Private Securities Transactions Analysis By Bill Singer" (*BrokeAndBroker.com Blog*, December 30, 2016).

A member must keep a record of its compliance with these obligations with respect to each written notice received and must preserve this record for the period of time and accessibility specified in SEA Rule 17a-4(e)(1).

Bill Singer's Comments: And this is why all those after-the-fact assertions by registered reps that they gave "oral" notice and got an "oral" okay that did not impose any conditions or limitations is to no avail. The firm must keep a record. The OBA Rule is premised upon the submission of a prior written notice. There aint' nothin' oral here folks.