

FINRA Adopts Rule to Limit a Registered Person From Being Named a Customer's Beneficiary or Holding a Position of Trust for or on Behalf of a Customer

Summary

FINRA adopted a new rule to limit any associated person of a member firm who is registered with FINRA (each a "registered person") from being named a beneficiary, executor or trustee, or to have a power of attorney or similar position of trust for or on behalf of a customer.¹ New FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer) protects investors by requiring all member firms to affirmatively address registered persons being named beneficiaries or holding positions of trusts for customers. The rule requires the member firm with which the registered person is associated, upon receiving required written notice from the registered person, to review and approve or disapprove the registered person assuming such status or acting in such capacity. The rule does not apply where the customer is a member of the registered person's "immediate family."² Rule 3241 becomes effective February 15, 2021.

The rule text is available in Attachment A.

Questions regarding this *Notice* should be directed to:

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Background & Discussion

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 hold a power of attorney or 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 addressed 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.⁴ Nonetheless, FINRA observed situations where registered representatives tried to circumvent firm policies, 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

Prior to the adoption of Rule 3241, FINRA took 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 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
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

New Rule 3241

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 has adopted new Rule 3241 to create a uniform, national standard to govern registered persons holding positions of trust.⁹ This new national standard better protects investors and provides consistency across member firms' policies and procedures. Rule 3241 provides that a registered person must decline:

1. being named a beneficiary of a customer's estate¹⁰ 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 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 customer¹¹ 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.¹²

The rule does not apply where the customer is a member of the registered person's immediate family. The rule also does not affect the applicability of other rules (*e.g.*, FINRA Rule 2150 regarding improper use of customer securities or funds). FINRA will 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 rule; however, the registered person must act consistent with the rule upon learning that he or she was named as a beneficiary or to a position of trust. The rule applies 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 rule. For example, if a customer named her registered person as her beneficiary without the beneficiary's knowledge, the rule would not apply and the registered person would not be in violation of the rule. However, when the registered person becomes 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 rule would apply and the registered person must act consistent with the rule (*i.e.*, by declining the bequest unless he or she provides written notice to and receives written approval from the member firm).

Firm Notice and Approval

To provide flexibility to member firms, the rule does not prescribe any specific form of written notice and instead permits a member firm to specify the required form of written notice for its registered persons.¹³ Upon receipt of the written notice, the rule requires 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;¹⁴ 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.¹⁵

If the member firm imposes conditions or limitations on its approval, the member firm is required to reasonably supervise the registered person's compliance with the conditions or limitations.¹⁶ 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 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 Rule 3241 and Rule 3270 regarding outside business activities would apply to the activities away from the firm.¹⁷

The rule requires a member firm to establish and maintain written procedures to comply with the rule's requirements.¹⁸ The rule also requires 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.¹⁹

Reasonable Assessment and Determination

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 or disapprove 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 does 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 rule does 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 rule 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 rule is designed to address.

If possible, as part of the reasonable assessment of the risks, FINRA expects 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 Rule

To address attempted circumvention of the restrictions (*e.g.*, by closing or transferring a customer's account), the rule defines "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.²⁰ Member firms have flexibility to reasonably design their supervisory systems to achieve compliance with the rule (*e.g.*, by using training, certifications or other measures). In addition, as discussed below, the rule applies where a registered person associates with a new member firm even though the registered person had been named as a beneficiary or to a position of trust prior to joining the firm.²¹

A registered person who does not have customer accounts assigned to him or her is not subject to the rule. 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 presents similar conflict of interest concerns as the registered person being so named. Accordingly, the rule does 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.²²

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

As is true of many professions, registered persons occasionally move between member firms. 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, the rule requires 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.²³

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 rule requires 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.²⁴

Endnotes

1. See Securities Exchange Act Release No. 90116 (October 7, 2020), 85 FR 65095 (October 14, 2020) (Order Approving File No. SR-FINRA-2020-020).
2. The rule defines "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 Rule 3241(c). FINRA interprets cousin in the "immediate family" definition to mean first cousins and not second or more distant cousins.
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).
5. *Id.*
6. *Id.*
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).
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. A member firm may choose to go beyond the rule's requirements, for example 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; or (2) further limit or prohibit

registered persons from being named a customer's beneficiary or to a position of trust for a customer.

10. For purposes of the rule, a customer's estate includes 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 Supplementary Material .02 to Rule 3241. The scope is consistent with includable property in a decedent's gross estate for federal tax purposes. See, e.g., [IRS FAQs on Estate Taxes](#).
11. 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 rule does not apply where the customer names either the member firm or an affiliated entity as his or her trustee. However, the rule does 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 rule 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.
12. See 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 is considered deriving financial gain from acting in such capacity.
13. Because the rule 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.
14. 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 expects 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).
15. See Rule 3241(b).
16. See Rule 3241(b)(3).
17. 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.
18. See Rule 3241(b)(4).
19. See Supplementary Material .03 to Rule 3241.
20. See Supplementary Material .01 to Rule 3241. A securities account includes, for example, a brokerage account, mutual fund account or variable insurance product account. For purposes of the rule, 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 rule's obligations (this is sometimes referred to as "check and application," "application way," or "direct application" business).

21. See Supplementary Material .04 to Rule 3241.
22. See Supplementary Material .06 to Rule 3241.
23. See Supplementary Material .04 to Rule 3241. For example, a registered representative was named a trustee by a customer who is not an immediate family member in 2018 (*i.e.*, prior to the effective date of Rule 3241) consistent with Member Firm A's procedures. Notice to and approval by Member Firm A is not required for the registered representative to continue serving as the customer's trustee after the rule becomes effective. However, if the registered representative left Member Firm A to become associated with Member Firm B after the rule became effective, Supplementary Material .04 applies 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.
24. See Supplementary Material .05 to Rule 3241. The rule applies 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 example, a registered representative was named a beneficiary of a customer who is not an immediate family member in 2018 (*i.e.*, prior to the effective date of Rule 3241), consistent with the firm's procedures, and the customer passes away after the rule became 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 rule 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.

For the non-beneficiary positions, the rule applies 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 rule.