



NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

750 First Street N.E., Suite 1140
Washington, D.C. 20002
202/737-0900
Fax: 202/783-3571
www.nasaa.org

January 24, 2020

By email to: pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street NW
Washington, DC 20006-1506

Re: **Regulatory Notice 19-36: Rule to Limit a Registered Person from Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer**

Dear Ms. Mitchell:

I am writing on behalf of the North American Securities Administrators Association, Inc. ("NASAA")¹ in response to the request for comment by the Financial Industry Regulatory Authority ("FINRA") on *Regulatory Notice 19-36: Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer* (the "Request for Comment").² Addressing the conflicts of interests that occur when a registered person is named as a beneficiary or is holding a position of trust³ for a customer is an important step in advancing investor protection. NASAA commends FINRA for its engagement and efforts on issues related to protections for senior investors – an area in which FINRA and NASAA have been able to collaborate successfully.

As proposed, Rule 3241 would allow a registered person to be named a beneficiary or hold a position of trust for a customer where the customer is an immediate family member or when the registered person's firm provides written approval.⁴ It is NASAA's position however, that a

¹ Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

² See Regulatory Notice 19-36: Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer, FINRA (November 11, 2019) available at <https://www.finra.org/rules-guidance/notices/19-36>.

³ For the purposes of this response, the term "position of trust" is defined as including but not limited to receiving a bequest; acting as power of attorney, trustee, and/or executor; or holding any other position of power or control over a customer's financial affairs.

⁴ NASAA, like FINRA, recognizes that there are differences in the duties and obligations that arise when a person is designated as a beneficiary versus being named to a position of trust. But serving in either of these

registered person 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. This prohibition should also apply to family members of the registered person and entities controlled by the registered person.⁵ Further, even if the rule were limited to immediate family members, the registered person should be required to seek prior written authorization from the member firm and the firm should be required to implement heightened supervision of the accounts.

Alternatively, if FINRA is inclined to move forward 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. Furthermore, the definition of immediate family members should be narrowed, and FINRA 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.

Justification for the above positions are more fully explained below in response to the specific questions raised by FINRA in the Request for Comment. As such, NASAA encourages FINRA to revise the rule as set forth above.

Responses to Certain Questions in the Request for Comment

Question 1. Are there approaches other than the proposed rule that FINRA should consider?

Yes. FINRA should revise the rule to prohibit registered persons being named as a beneficiary or holding a position of trust for a customer unless they are an immediate family member. Further, the registered person should be required to seek prior written authorization from the member firm and the firm should be required to implement heightened supervision of the accounts. This approach is more consistent with other self-regulatory organizations in North America and aligns with policies and procedures currently in place at some FINRA member firms.⁶

In Canada, the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association (MFDA)⁷ limit the instances when a registered person may act in a position of trust for a customer and mandate that protective measures be implemented when registered persons assume these roles. IIROC amended its dealer member rules concerning

capacities creates potential conflicts of interest. Therefore, it is NASAA's position that the methods of addressing them should be the same.

⁵ The prohibitions recommended in this letter for registered persons should also apply to immediate family members of the registered person and entities controlled by the registered person. This approach would prevent registered persons from attempting to circumvent the prohibitions that would otherwise be applicable to them.

⁶ See FINRA Regulatory Notice 19-36, page 3 noting 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."

⁷ IIROC is the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. The MFDA is a national self-regulatory organization for the distribution side of the Canadian mutual fund industry.

personal financial dealings and outside business activities in 2017. As amended, the rules prohibit approved persons of a dealer member from directly or indirectly engaging in any personal financial dealings with customers. Under the rules there is a prohibition on acting as a power of attorney, trustee, executor, or otherwise having full or partial control or authority over the financial affairs of a customer,⁸ unless the customer is a related person under the *Income Tax Act* (Canada).⁹ The prohibition is premised on the fact that that these are personal financial dealings and any personal financial dealings with customers creates an unacceptable conflict of interest between the dealer member employee and the customer. The rules further provide that when an approved person is appointed by a family member, they must receive prior approval from the dealer member.

Similarly, the MFDA amended its rules in 2017 to prohibit a member or approved person from having full or partial control or authority over the financial affairs of a customer, unless the customer was a related person as defined by the *Income Tax Act* (Canada).¹⁰ This includes accepting or acting upon a power of attorney from a customer, accepting an appointment to act as a trustee or executor of a customer, or acting as a trustee or executor in respect of the estate of a customer. The MFDA also mandates that an approved person notify the member of an appointment and obtain written member approval prior to accepting or acting upon the control or authority.

A rule limiting registered persons being named as a beneficiary or holding a position of trust to immediate family members only, with prior member firm authorization and heightened supervision of the accounts, would provide the investor protections necessary to address the conflicts of interest identified in the Request for Comment.

Question 2. Should the scope of the proposed rule be expanded to encompass other requirements?

Yes. The scope of the proposed rule should be expanded to address the prohibitions and requirements discussed below.

A. Prior Authorization from the Member Firm

If the rule permits a registered person to be named a beneficiary or to act in a position of trust for a customer, regardless of whether the customer is an immediate family member or not, the rule should require that in all circumstances the registered person seek prior written approval from the member firm. The rule should also provide guidance to the member firm regarding the information that should be reviewed before approving such requests. At a minimum the registered

⁸ In the Canadian context the “registered individuals” acting as a dealing representative or an advising representative would deal with or advise clients.

⁹ IIROC Rule 42 on general Conflicts of Interest would likely, in most instances, prevent an IIROC member from being permitted to be named a beneficiary from a client. Most IIROC member firms would have policies and procedures prohibiting such appointment due to the inherent conflict, however there may be circumstances that warrant an exception in firm policies and procedures.

¹⁰ MFDA Rule 2.1.4 would suggest being named a beneficiary from a client would create an unacceptable conflict of interest.

person should be required to disclose:

- relevant information about the customer, including the length of time the registered person has known the customer;
- the nature of any special or familiar relationship between the registered person and the customer;
- the circumstances precipitating any appointment or designation, or any information that might make the customer vulnerable; and
- identification of the role(s) in which the registered person is being appointed.

In addition, the rule should provide guidance to the member firm when reviewing the written requests, and require that the process of the approval be documented to include:

- the steps that the member firm undertook to assess the risk prior to the registered person being approved;
- the steps that the member firm will take to minimize the conflict of interest;
- how the member firm communicated to the customer the risk created by the appointment so that the customer appreciates the risk; and
- an outline of the supervisory measures that will be taken by the member firm.

B. Heightened Scrutiny of Approved Accounts

As written, the rule does not require member firm approval for family members and only requires member firms to “reasonably supervise” the registered person’s compliance with conditions or limitations placed on the account. This rule is insufficient as there are inherent conflicts of interest present even where the customer is an immediate family member of the registered person. The member firm must closely monitor the account even where formal conditions are not imposed by the firm. For instance, firms could treat these relationships like heightened supervision situations and place additional review on trades and transactions in the account and withdrawals from the account to make sure the registered person is making suitable recommendations and not taking advantage of the position of trust.

Heightened supervision of any related accounts is appropriate as a guard against abuse of the power and trust that come with these relationships, including where the registered person and customer have a familial relationship. The National Council on Aging reports that in almost 60% of elder abuse and neglect incidents, the perpetrator is a family member with two-thirds of the perpetrators being adult children or spouses.¹¹

In the circumstances where a senior investor has become isolated from family or friends, a registered person may think it is appropriate to step in to fill the gap. While these relationships can start with good intentions, they have the potential to become exploitative situations. In more malevolent cases, a registered person may “groom” a customer with the goal of exploitation. To

¹¹ See <https://www.ncoa.org/public-policy-action/elder-justice/elder-abuse-facts/>

illustrate this reality, attached as Appendix “A”¹², is a state sentencing memorandum from a case where a registered representative from Maine stole millions of dollars from his widowed senior customer and her disabled adult son. He was able to perpetrate this abuse and to gain positions of trust by exploiting a long-standing personal relationship (albeit not as an immediate family member).

Additionally, responsible registered persons should be familiar with resources available to customers who may be isolated or estranged from family and friends. Registered persons should become aware and be knowledgeable of the existing network of resources available to assist customers such as the local adult protective services, non-governmental organizations that specialize in providing services and support for the elderly, local bar associations and legal aid services, and similar agencies that may be able to assist when a customer is unable to turn to friends or family to assist with financial affairs.

C. Modification of Account Applications to Assure Customer Awareness

FINRA should require member firms to advise customers in the account application of the restrictions applicable to naming a registered person, an immediate family member of the registered person, or an entity controlled by the registered person as a beneficiary or to a similar position of trust for the customer. While a registered person has no control as to who a customer ultimately designates when the customer does not consult the member firm or representative, such communication at account opening would ensure customers are fully aware of the potential problems and conflicts created when designating their broker as beneficiary or appointing them to serve in a position of trust. In addition, the member firm should ask customers about existing executor, trustee, and power of attorney arrangements, and similar positions of trust, and whether the customer named the registered person as a beneficiary. The member firm should ask this during account opening and periodically thereafter. Such an inquiry could be included in regular customer profile updates.

D. Interview Customers Outside the Presence of the Registered Person

To the extent practicable, when reviewing a request to approve a registered person to be named as a beneficiary or to act in a position of trust, member firms should be required to interview the customer outside the presence of the registered person. This should be a practice in all instances, whether the registered person is assuming the role for a non-family member or a family member. This practice will ensure that the request to appoint the registered person is well informed and has not been coerced. Where it is not possible to interview the customer, the member firm should be required, at the very least, to verify that the customer indeed directed the appointment of their own volition and did not feel pressure by the registered person to appoint the registered person to the position of trust.

¹² This memorandum was also appended to NASAA’s comment letter in response to FINRA Regulatory Notice 19-27.

E. Any Member Firm May Adopt Policies to Prohibit Members from These Roles

It should be made clear that any member may adopt policies and procedures that prohibit their members from acting in these roles for non-family members, even if the FINRA rule permits the registered person to be named a beneficiary or to act in a position of trust for a customer.

F. The Definition of “Immediate Family Member” Should be Narrowed

FINRA should revise and narrow the definition of “immediate family member” to prevent abuse of the following language: “any other person who the registered person financially supports, directly or indirectly, to a material extent.” NASAA recommends that FINRA require that any such person “who the registered person financially supports” must reside in the same household as the registered person.

G. The Prohibition Should Apply Where the Registered Person is Unaware of the Appointment

NASAA would support a rule that prohibits registered persons from being named a beneficiary or to act in a position of trust for a customer even in situations where a registered person is named without his or her knowledge. NASAA does not, however, object to a rule that would permit registered persons to be named beneficiaries of family-member customers where the registered person was unaware of the designation.

In the case where a registered person is aware of the intent of a non-related customer to appoint them to a position of trust, the registered person should decline such designation. Where the registered person becomes aware of the appointment after the customer is incapacitated or has passed away, the registered person should decline the appointment in favor of an alternate person. If there is no alternate person immediately available to assume the position, the rule should permit the registered person who has been named to the position of trust to accept the appointment on an interim basis if the customer’s account is temporarily transferred to a different registered person while the original registered person on the account obtains a replacement to serve in that position. Obtaining a replacement may require the registered person to seek the assistance of the court or local adult protective services agency. In situations where there is no one else to be placed in the position of trust or when the registered person would be authorized to act in a position of trust, the member firm should be required to permanently assign the customer account to another representative.

Registered persons who were previously named to positions of trust prior to the implementation of this rule should be required to take steps to unwind these relationships, to the extent possible.

In the case where a registered person is aware of the intent of a non-related customer designating them as a beneficiary or appointing them to a position of trust, the registered person should decline such designation. Where the registered person becomes aware of being designated

beneficiary by a customer only after the death of the customer the registered person should be required to immediately report the designation to their member firm who can determine whether there is a conflict of interest and how to properly manage the conflict of interest. Member firms should have written supervisory procedures addressing how the firm will handle these situations and address all conflicts of interest.

H. Prohibit the Registered Person, Their Immediate Family, and Controlled Entities From These Roles

The rule should prohibit the registered person's immediate family members and entities controlled by the registered person from being named beneficiary or to act in a similar position of trust for the registered person's customer. While Supplementary Material .06 states that the registered person instructing the customer to name another person to be named a beneficiary or receive a bequest is inconsistent with the rule, it does not go far enough. NASAA notes that in many cases the practice of allowing representatives to act in these capacities is already prohibited by member firms. In some cases, because the practice is prohibited by the member firm, the registered person may have an immediate family member, or an entity controlled by the registered person to be named while the registered person continues to direct the customer's affairs.

Question 7. Is the time period in the definition of “customer” for purposes of the proposed rule (i.e., a customer who in the previous six months had a securities account assigned to the registered person) a sufficient period to mitigate potential conflicts of interest and to deter circumvention of the rule?

A lookback period of 12 months is more appropriate than the 6-month period proposed in the rule as the longer look back period would help prevent circumvention of the rule.

Question 8. Should the proposed rule apply to beneficiary status and positions of trust that were entered into prior to the existence of a broker-customer relationship?

The rule should include language applicable to pre-existing positions. Supplementary Material .05 discusses pre-existing positions; however, including language in the rule is the appropriate way to address this important circumstance. The conflicts noted above are no less significant or concerning because the position of trust was established prior to the brokerage relationship.

NASAA is of the view that anytime a registered person is to be named as a beneficiary or to act in a position of trust by a customer, the relationship should be screened. There should not be a “grandfathering” clause for pre-existing positions. Ultimate concern should be for customers' well-being and ensuring that conflicts of interest are avoided. Moreover, member firms should ask about the existence of such relationships during the hiring process so that the relationship can be screened before the individual is hired.

Jennifer Piorko Mitchell

January 24, 2020

Page 8 of 8

Question 9. Should the proposed rule require a specific form of written notice for requesting approval by a registered person to be named a beneficiary or to a position of trust?

NASAA supports requiring a specific form of written notice for requesting approval. However, absent a specific form, guidance should be provided regarding the information the registered person should provide the member firm as discussed above.

Conclusion

NASAA supports FINRA's ongoing efforts to protect senior investors and appreciates the opportunity to comment. It is NASAA's position that FINRA can take further steps to assure appropriate protections are in place to address the conflicts of interest presented by a registered person being named a beneficiary of a customer, or to hold a position of trust for a customer.

If you have questions about these comments, please contact Joseph Brady, NASAA's Executive Director.

Sincerely,

A handwritten signature in black ink, appearing to read "C Gerold". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Christopher Gerold
NASAA President
Chief, New Jersey Bureau of Securities