



Risk Management Update March 2011

REGULATORY UPDATE: NEW REPORTING REQUIREMENTS FOR OUTSIDE BUSINESS ACTIVITIES

Regulation of outside business activities, commonly referred to as “OBAs,” continues to be a hot issue in the broker-dealer world. On December 15, 2010, FINRA adopted Rule 3270, which expands the reporting requirements for OBAs. Effective June 15, 2011,¹ member firms will have to comply with these new requirements which now state:

“Any registered person is prohibited from being an employee, independent contractor, sole proprietor, officer or director...being compensated or having a reasonable expectation of compensation as a result of any business activity outside the scope of the relationship with the member firm, *unless* prior written notification is provided to the member firm.”²

What Has Changed

Prior to the adoption of Rule 3270, FINRA Rule 3030 prohibited any registered person from being employed by or accepting compensation from any person as a result of any outside business activity, unless he or she provided *prompt* written notification to the member firm.³ In contrast, under Rule 3270, registered persons must give notification to the member firm *prior* to engaging in the OBA.

In accordance with Rule 3010, each member firm needs to have the ability to supervise the activities of each registered representative, registered principal and other associated person to ensure compliance with applicable rules and regulations.⁴ Consequently, it is rational that registered persons should not be permitted to engage in an OBA without the firm's prior knowledge. Under the new rule, by requiring a notification standard prior to engaging in an activity, member firms will have a more adequate opportunity to review the OBA, determine if the activity is properly categorized as an OBA, and make a determination as to whether the activity will compromise the registered representative's responsibilities to the member firm and its customers.⁵

¹SEC Approves new consolidated FINRA Rules, FINRA REGULATORY NOTICE 10-49, December 2010, at 4

² Federal Register Vol. 75, No. 168, Tuesday, August 31, 2010.

³ FINRA Rule 3030.

⁴ FINRA Rule 3010.

⁵ FINRA REGULATORY NOTICE 10-49, December 2010, at 4

Scope of Reporting

Under the former Rule 3030, reporting of OBAs for a registered representative was tied to receipt of compensation or employment. However, in an attempt to “harmonize and simplify” the standards for an OBA,⁶ new Rule 3270 includes an expanded requirement to report that OBA which the representative has a “reasonable expectation of compensation.” This change helps to clarify reporting requirements by setting that registered representatives must provide OBA notification to a firm if compensation is *expected* - and not only when it is in fact received.

How to Prepare for the Heightened Requirements

According to the supplemental materials included with the proposed Rule 3270, prior to approving an OBA, member firms should:

1. Consider whether the OBA will interfere with the registered representative’s responsibilities to the firm;
2. Record what factors and considerations were used to approve or reject the OBA; and
3. Maintain documents indicating the member firm’s approval or rejection of the OBA.⁷

Compliance Risk Management Tips

In order to effectively deploy enhanced written supervisory procedures relating to the new OBA requirements, member firms should consider the following:

1. Update the firm’s written supervisory procedures and require registered representatives to sign an acknowledgment form indicating their receipt and understanding of the new policy protocols;
2. Include the new OBA requirements in your 2011 Firm Element Training Program;
3. Send out a written communication to your registered representatives, perhaps in the form of a blast email or quarterly compliance newsletter, informing them of the new OBA reporting requirements; and
4. Update branch managers and hold them accountable for gathering new OBA reporting forms from their assigned representatives.

For more information regarding Rule 3270 and the internal controls for firms to consider for complying with these new requirements, please contact us at info@corecls.com.

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⁶ Federal Register Vol. 75, No. 168, Tuesday, August 31, 2010

⁷ *Id.*