



## FINRA proposes new rule requiring approval for registered persons holding positions of trust for non-family member customers

### Financial Services Alert

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The Financial Industry Regulatory Authority, Inc. (FINRA) proposed a new rule on June 23 to require broker-dealers to approve registered persons being named as a beneficiary or acting as a trustee or holding power of attorney (POA) for customers who are not immediate family members. The proposal was first published for comment in Regulatory Notice 19-36. According to FINRA, these positions create conflicts of interest in which registered persons may benefit from using “undue and inappropriate influence over important financial decisions to the detriment of a customer” and may remain unknown to the broker-dealer or other beneficiaries or surviving family members for years. The regulator noted that senior investors who are isolated or experiencing cognitive declines are particularly vulnerable to such harm.

While many broker-dealers impose their own prohibitions or limitations, FINRA stated it has continued to observe misconduct despite various measures taken by such firms and the regulator to combat it. Therefore, to better protect investors, FINRA is proposing a uniform and national standard to govern registered persons holding positions of trust. As described in more detail below, the proposal is largely principles-based and requires firms to adopt written supervisory procedures setting forth a written notice and approval process for these arrangements,

leaving it to individual firms to evaluate conflicts of interest.

Under the proposal, a registered person would be required to decline being named a beneficiary of a customer's estate or receiving a bequest from a customer's estate upon learning of such status unless one of the following conditions were satisfied:

- The customer is a member of the registered person's immediate family or
- Upon learning of such status, the registered person provides written notice describing the proposed status to his or her broker-dealer and receives written approval prior to being named a beneficiary or receiving a bequest. If the broker-dealer disapproves the status or places conditions or limitations on it, the registered person may not assume such status or must comply with such conditions or limitations.

Similarly, a registered person would be required to decline being named as an executor or trustee or holding a POA or similar position for or on behalf of a customer upon learning of such status unless one of the following conditions were satisfied:

- The customer is a member of the registered person's immediate family or
- Upon learning of such status, the registered person provides written notice describing the position and proposed role to his or her broker-dealer and receives written approval prior to acting in such capacity or receiving any fees, assets, or other benefit in relation to acting in such capacity. As above, if the broker-dealer disapproves the status or places conditions or limitations on it, the registered person may not assume such status or must comply with such conditions or limitations. Under this condition, the registered person may not derive financial gain (other than reasonable and customary fees) from acting in such capacity.

Upon receipt of a written notice, the broker-dealer would be required to perform a reasonable risk assessment of the registered person's assumption of such status, including an evaluation of whether it would interfere with or otherwise compromise the registered person's responsibilities to the customer. While the proposed rule text does not specifically address the assessment, FINRA provided guidance in the rule filing about factors that should be considered, 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 (eg, excessive trading), and
8. Any indicia of customer vulnerability or undue influence of the registered person over the customer.

The broker-dealer would be required to make a reasonable determination of whether to approve, condition or limit, or disapprove such status. Upon completion of the assessment, the broker-dealer would be required to provide written notice of its decision to the registered person. If the broker-dealer imposed conditions or limitations, it would be required to reasonably supervise the registered person's compliance with such conditions or limitations. FINRA noted that if the customer account is at the member firm, there would be more information from which red flags

could surface; conversely, if the account were held away, the broker-dealer would be required not only to supervise the activity but also to treat the position as an outside business activity subject to FINRA Rule 3270.

“Immediate family” would be defined as 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 would also include step and adoptive relationships.

“Customer” would include any customer who has, or in the previous six months had, a securities account assigned to the registered person at any FINRA member firm. The six-month lookback is designed to prevent circumvention of the restrictions by simply closing or transferring a customer’s account. A customer’s estate would include 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.

The proposal would also cover positions held prior to the person associating with the broker-dealer. Specifically, if the registered person were named as a beneficiary or to a position of trust prior to the registered person’s association with a broker-dealer, then the registered person would have 30 calendar days upon association to provide notice to and receive approval from the new broker-dealer employer to maintain the beneficiary status or position of trust. According to FINRA, agreements to assume such status or act in such capacity that were entered into prior to the existence of a broker-customer relationship raise similar conflict of interest concerns; under the proposal, the broker-dealer also must evaluate these in accordance with the rule.

The proposal also provides that a registered person instructing or asking a customer to name another person (eg, a spouse or child of the registered person) to be a beneficiary of the customer’s estate or to receive a bequest from the customer’s estate would present similar conflict of interest concerns as the registered person being so named. Thus, such action would be inconsistent with the rule.

Broker-dealers would be required to establish and maintain written supervisory procedures to comply with the rule. They also would be required to maintain records of written notices and approvals 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 broker-dealer had terminated.

Comments on the proposal are due within 45 days after its publication in the Federal Register.

If you have any questions concerning FINRA’s rule proposal, please contact the authors, your DLA Piper relationship partner or a member of the DLA Piper Financial Services team.

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