

Regulatory Notice 19-36

FINRA Requests Comment on a Proposed 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

Comment Period Expires: January 10, 2020

Notice

Comments

Summary

Investment professionals often develop close and trusted relationships with their customers, which in some instances have resulted in the investment professional being named the customer's beneficiary, executor or trustee, or holding a power of attorney or a similar position for the customer. Being a customer's beneficiary or holding a position of trust may present significant conflicts of interest, and FINRA has previously taken steps to address misconduct in this area.

To further address potential conflicts of interest, FINRA is proposing 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. The proposed rule would protect investors by requiring all member firms to affirmatively address registered persons being named beneficiaries or holding positions of trusts for customers. The proposed rule would require the member firm with which the registered person is associated, upon receiving written notice from the registered person, to review and approve the registered person assuming such status or acting in such capacity. The proposed rule would not apply where the customer is a member of the registered person's "immediate family."¹

Recognizing that a registered person and customer may have a close and longstanding friendship or relationship that may be akin to, but not actually, a familial relationship, the proposed rule would 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, FINRA would expect a member firm to employ heightened scrutiny in assessing a registered person's request to be named a beneficiary of or receive a bequest from a customer's estate. Approval should be given only when the member firm has made a reasonable determination that the registered person assuming such status does not present a risk of financial exploitation that the proposed rule is designed to address.

If the proposed rule is approved, FINRA would assess registered persons' and firms' conduct pursuant to the rule to determine the effectiveness of the rule in addressing potential conflicts of interest and evaluate whether additional rulemaking or other action is appropriate.

The proposed rule text is available in Attachment A.

Questions regarding this *Notice* should be directed to:

- James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270; or
- Jeanette Wingler, Associate General Counsel, OGC, at (202) 728-8013.

Questions concerning the Economic Impact Assessment in this *Notice* should be directed to:

- Lori Walsh, Deputy Chief Economist, Office of the Chief Economist (OCE), at (202) 728-8323; or
- Dror Y. Kenett, Economist, OCE, at (202) 728-8208.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by January 10, 2020.

Comments must be submitted through one of the following methods:

- Emailing comments to pubcom@finra.org; or
- Mailing comments in hard copy to:
Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.²

Before becoming effective, a proposed rule change must be filed with the Securities and Exchange Commission (SEC) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).³

Background & Discussion

Being named a customer's beneficiary, executor or trustee, or holding a power of attorney or a similar position for or on behalf of a customer may present significant conflicts of interest for investment professionals. Conflicts of interest can take many forms and can result in registered persons taking advantage of being named beneficiaries or holding positions of trust for personal monetary gain. Problematic arrangements may not become known to the member firm or customer's beneficiaries or surviving family members for years. Senior investors who are isolated or suffering from cognitive decline are particularly vulnerable to harm.⁴

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.⁵ Nonetheless, FINRA has observed situations where registered representatives have 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.⁶

FINRA has taken steps to address misconduct in this area, including:

- identifying effective practices for member firms;⁷
- listing 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 a similar position for or on behalf of a customer who is not a family member;⁸
- 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);
- reviewing regulatory filings made by firms on Form U5 (Uniform Termination Notice for Securities Industry Registration related to terminations for cause) disclosing related issues;
- reviewing matters referred by an arbitrator to FINRA for disciplinary investigation; and
- depending on the facts and circumstances of the conduct as 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).⁹

Proposal

To further address potential conflicts of interest in this area, FINRA proposes adopting new Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer) providing 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 customer unless:
 - a. the registered person provides written notice upon learning of such status 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.¹¹

The proposed rule would not apply where the customer is a member of the registered person's immediate family.¹² If the proposed rule is approved, FINRA would assess registered persons' and firms' conduct pursuant to the rule 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 proposed rule; however, the registered person must act consistent with the proposed rule upon learning that he or she was named as a beneficiary or to a position of trust. The proposed rule would apply 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 proposed rule.

Firm Notice and Approval

The proposed rule would permit a member firm to specify the required form of written notice for its registered persons. Upon receipt of the written notice, the proposed rule would require 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 an evaluation of whether it will interfere with or otherwise compromise the registered person's responsibilities to the customer; 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.¹³

If the member firm imposes conditions or limitations on its approval, the firm would be required to reasonably supervise the registered person's compliance with the conditions or limitations.¹⁴

The proposed rule would require a member firm to establish and maintain written procedures to comply with the rule's requirements.¹⁵ The proposed rule would also require 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, which is similar to the requirement in Rule 3240.¹⁶

Reasonable Assessment and Determination

FINRA expects that a member firm's assessment would take into consideration several factors, such as:

- any potential conflicts of interest in the registered person being named a beneficiary or holding the position of trust;
- the length and type of relationship between the customer and registered person;
- the customer's age;
- the size of any bequest relative to the size of a customer's estate;
- 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 individual unable to protect his or her own interests;
- any indicia of improper activity or conduct with respect to the customer or the customer's account (e.g., excessive trading); and
- any indicia of customer vulnerability or undue influence of the registered person over the customer.

For example, a representative'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 representative's request to hold a position of trust for a longstanding friend. FINRA would 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 to the member firm's assessment.

The proposed rule would 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 that the proposed rule is designed to address (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).

If possible, a firm should consider discussing 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 Proposed Rule

To address attempted circumvention of the restrictions (e.g., by closing or transferring a customer's account), the proposed rule would define "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.¹⁷ 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 would present similar conflict of interest concerns as the registered person being so named. Accordingly, the proposed rule would 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.¹⁸

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

Registered representatives move with some frequency 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, the proposed rule would require 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.¹⁹

Pre-Existing Beneficiary Status and Positions of Trust

Conflict of interest concerns are also raised by beneficiary status and positions of trust that were 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. Therefore, the proposed rule would require 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.²⁰ Comment is specifically requested on whether these prior relationships involve similar concerns for broker-dealers and their customers.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet its regulatory objective.

Regulatory Need

FINRA is active in its efforts in protecting senior and financially vulnerable investors from exploitation. In the context of these efforts, and with evidence of a growing trend of such exploitation,²¹ FINRA has recognized the potential conflict of interests that can arise from having a customer name their registered representative as a beneficiary or to a position of trust. To mitigate such conflicts of interest, as well as any potential resulting harm, FINRA is proposing adoption of FINRA Rule 3241.

Economic Baseline

The economic baseline for the proposed rule is based on the existing firm policies and practices on beneficiary status and positions of trust, as well as the prevalence of registered persons being named in such capacity. To gauge the extent of both, FINRA has sought information with regard to current practices from a sample of member firms and trade associations. Specifically, FINRA sought information on current practices from firms represented on FINRA advisory committees and engaged trade associations in conversations. Information obtained indicates that the majority of firms have existing policies in place with respect to registered persons being named beneficiaries or to positions of trust.

Almost all firms in FINRA's survey indicated that they currently do not permit a registered person to be named a beneficiary for a customer who is not a family member, with some variations on how family relationship is defined. Unlike the case of being named a beneficiary, firms are more likely to allow registered persons to be named as beneficiaries or to positions of trust, in compliance with the firm's internal processes and procedures. Registered persons are typically required to request approval to be named as a beneficiary or to a position of trust. Approval is usually requested through the outside business activities (OBA) submission process. Monitoring of compliance with the procedures is conducted through the member firms' various control functions including, for example, branch exams, annual questionnaire responses, and supervisory review of emails. FINRA understands, based on anecdotal information collected from FINRA's survey, that over the past five years more than 85 percent of such requests by registered persons have been on behalf of immediate family members.

Economic Impacts

FINRA believes that the economic impacts of the proposed rule would result in minimal costs to member firms, while benefiting the investor community by providing additional investor protections where such policies do not currently exist, are not consistently applied or are less restrictive than the proposed changes.

The proposed rule will ultimately benefit the investor community, and promote greater trust in the brokerage industry, by reducing the potential exploitation of financially vulnerable investors. FINRA believes that establishing an industry-wide benchmark for situations in which registered persons request to be named beneficiaries or to positions of trust mitigate potential conflicts of interest consistently across the industry for all customers.

As discussed above, the majority of member firms in FINRA's sample survey indicated that they have policies in place to prohibit in most cases a registered person from being named a beneficiary of a customer who is not a family member, but may permit a registered person to be named as an executor or trustee or hold a power of attorney, depending on the facts and circumstances. Anecdotal information collected by FINRA indicates that the majority of member firms in the sample survey have in place both specific policies and procedures to manage such requests, as well as mechanisms to monitor compliance. FINRA believes that where member firms already have these types of policies and procedures in place, the cost should be minimal.

Member firms with different policies and procedures, whether more or less restrictive than proposed here, would likely incur costs to amend them. Those firms required to establish a higher standard for these activities may also incur new on-going supervisory costs. The same would be true for those member firms with no current policies or procedures covering these situations. Member firms with existing practices that are more restrictive than the proposed rule could maintain those policies. However, member firms altering their current policies and procedures to be in alignment with the proposal are expected to incur one-time costs to do so. Member firms will also incur some costs to provide training on the new requirements for registered persons.

FINRA recognizes that the proposal can result in a diminishing of customer choice in identifying a person to serve in a capacity of trust. There may be circumstances where the registered person represents a better alternative to the customer than other available options. Despite the potential loss of an appropriate person to serve in a capacity of trust, FINRA believes that this cost is justified by the protections afforded to investors by significantly mitigating the particular conflict of interest.

FINRA recognizes that investment advisers, as well as other financial services professionals under different regulatory oversight, potentially have similar conflicts of interest with their customers when engaged in these activities. This is the case because the conflict of interest is not unique to the brokerage industry. Rather, the conflict arises from the pecuniary benefits that may accrue because of the nature of the relationship between the customer and the financial professional. However, there is no available information or data to permit FINRA to gauge the prevalence and impact of such relationships between these other financial professionals and their customers. Further, it is difficult to gauge the circumstances under which differences in the regulatory treatment of this activity would impact competition.

Alternatives Considered

FINRA considered various alternatives to the provisions in the proposed rule. One alternative considered was prohibiting a registered person from inducing a customer to name the registered person as a beneficiary of the customer's estate. FINRA believes that the current proposal is a better approach for addressing potential conflicts of interest because of the inherent difficulty in proving inducement. Second, FINRA considered an outright prohibition of some or all positions of trust, but decided against that approach as some positions of trust, if properly known to and supervised by member firms, may benefit customers.

Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA specifically requests comment concerning the following questions:

1. Are there approaches other than the proposed rule that FINRA should consider?
2. Should the scope of the proposed rule be expanded to encompass other requirements?
3. What are member firms' current practices regarding a registered person being named a beneficiary or to a position of trust for or on behalf of a customer? Would the proposed rule change firms' current practices?
4. If your firm currently has procedures regarding a registered person being named a beneficiary or to a position of trust for or on behalf of a customer, on an annual basis, how many requests are made by registered persons to be named beneficiaries or to positions of trust for a: (i) non-immediate family member; or (ii) for an immediate family member?

5. If your firm currently has procedures regarding a registered person being named a beneficiary or to a position of trust for or on behalf of a customer, has a registered person failed to provide notice to the firm or otherwise comply with the procedures? If so, how prevalent is the problem and how has your firm addressed the non-compliance with firm procedures?
6. Do dually-registered firms have comparable procedures for broker-dealer registered persons and investment adviser representatives regarding being named a beneficiary or to a position of trust for or on behalf of a customer?
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?
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?
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?
10. What other economic impacts, including costs and benefits, might be associated with the proposal? Who might be affected and how?
11. Would the proposal impose any other competitive impacts that FINRA has not considered?

Endnotes

1. The proposal would define the term “immediate family” to include “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 whom the registered person financially supports, directly or indirectly, to a material extent. The term includes step and adoptive relationships.” See proposed Rule 3241(c).
2. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
3. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
4. 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).
5. 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).
6. *Id.*
7. *Id.*
8. See [2018 Regulatory and Examination Priorities Letter](#) (January 2018) and [2019 Risk Monitoring and Examination Priorities Letter](#) (January 2019).
9. 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).
10. For purposes of the proposed rule, 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. See proposed Supplementary Material .02 to Rule 3241. The proposed 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. See proposed Rule 3241(a).
12. The proposed rule also would not affect the applicability of other rules (e.g., FINRA Rule 2150).
13. See proposed Rule 3241(b).
14. See proposed Rule 3241(b)(3).
15. See proposed Rule 3241(b)(4).
16. See proposed Supplementary Material .03 to Rule 3241.
17. See proposed Supplementary Material .01 to Rule 3241. A securities account would include, for example, a brokerage account, mutual fund account or variable insurance product account. For purposes of this proposed 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 proposed rule’s obligations (this is sometimes referred to as “check and

application," "application way," or "direct application" business). However, a registered person who does not have customer accounts assigned to him or her would not be subject to the proposed rule.

18. See proposed Supplementary Material .06 to Rule 3241.

19. See proposed Supplementary Material .04 to Rule 3241.

20. See proposed Supplementary Material .05 to Rule 3241. The proposed rule would apply 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 the non-beneficiary positions, the proposed rule would apply 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 proposed rule.

21. See, e.g., Consumer Financial Protection Bureau, Office of Financial Protection for Older Americans, Suspicious Activity Reports on Elder Financial Exploitation: Issues and Trends (Feb. 2019). The Report found that suspicious activity report (SAR) filings on elder financial exploitation quadrupled from 2013 to 2017, with financial institutions filing 63,500 SARs reporting elder financial abuse in 2017. The Report also states that these SAR filings likely represent only a tiny fraction of the actual 3.5 million incidents of elder financial exploitation estimated to have happened that year. As covered in the Report, financial institutions that must file SARs include banks, casinos, money services businesses, brokers or dealers, insurance companies, mutual funds, futures commissions merchants and introducing brokers in commodities, loan or finance companies, and housing government-sponsored enterprises.

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