What is a Private Securities Transaction?  
(FINRA Rule 3040)

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This course will address the following topics:
- What is a security?
- What does the FINRA Rule 3040 say about private securities transactions
- FINRA Sanctions for Private Securities Transactions

This course includes:
- Three Lessons
- 3 Quizzes
- 1 Online Final Exam
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Introduction:
The number of FINRA sanctions against registered personnel engaged in unauthorized, private securities transactions (often referred to as “selling away”) underscores the importance of summarizing terms associated with securities transactions (Lesson 1), analyzing the FINRA rule (3040) regarding “private security transactions” (Lesson 2) and reviewing both recent sanctions (fines, suspensions, and industry bars) and the guidelines by which FINRA assesses those penalties for private security transactions (Lesson 3).

In this course, the student will learn to:
- Define what various securities instruments have in common
- Recognize different types of securities instruments
- Analyze FINRA’s rule (3040) regarding private securities transactions
- Appreciate that approvals and requirements vary among Broker-Dealers
- Make choices in hypothetical or real situations
- Analyze the implications of improper actions involving personal securities transactions
- Review recent FINRA sanctions involving personal securities transactions
- Review the FINRA guidelines for determining those sanctions
Pre-Assessment: (5)

1) A security can involve:
   I  Equity
   II Debt
   III Cash
   IV Loan
   
   a. I and III
   b. II and IV
   c. All
   d. None

2) A simplified definition of a security might be:
   I  Purchase of an asset, used only for personal use
   II Purchase of an asset managed by a third party with the expectation of appreciating value
   III Sale of an asset used solely for personal use
   IV Sale of an asset managed by a third party with the expectation of appreciating value
   
   a. I and II
   b. I and III
   c. II and IV
   d. III and IV

3) FINRA registered investment bankers, stock brokers, and investment advisors may have independent, paid fiduciary relationships involving securities with personal clients, outside of their Broker-Dealers.
   
   a. Always
   b. Sometimes
   c. Never
   d. If they are Registered Principals, but not Registered Representatives

4) FINRA presumes that Broker-Dealers are responsible for all securities related business conducted by their affiliated personnel IF it is conducted under contract with the firm.
   
   a. Always
   b. Sometimes
   c. Never
5) FINRA presumes that Broker-Dealers are responsible for securities related business conducted by their affiliated personnel IF it is conducted OUTSIDE the firm:

a. Always
b. Sometimes
c. Never

6) Which of the following acronyms does not involve securities?
   a. REIT
   b. ADR
   c. FBI
   d. CMO

7) Which of the following financial accounts is not a security?
   a. Savings account
   b. Variable annuity account
   c. Money Market account
   d. Municipal Bond account
Answers to Pre Assessment:
1 C
2 C
3 A
4 A
5 A
6 C
7 A
Lesson 1: According to resources accessible to the laymen and the FINRA licensed professional, what is a security?

In this lesson, the student will learn to:
• Define the term “security” simply
• Review terms associated with securities transactions
  o available to laymen on state securities board websites and
  o tested in the Series 7 FINRA licensing exam

Introduction:

Every industry has its jargon, and “insiders” may use terms differently than “outsiders.” For this reason, judicious and ethical investment advisors and wealth managers spend a lot of time carefully explaining securities risks and alternatives to their clients. Even if one understands the term, “security,” there is still room for confusion, since securities laws and language vary from state to state. In addition, clever financial professionals continue to develop new securities instruments for investors to consider. The issues are complex enough to support the livelihoods of many well trained and well paid securities attorneys and compliance professionals.

This course is prompted by the number of FINRA sanctions against “private securities transactions” by FINRA registered personnel. The implication is that either they don’t understand the term, “securities” - or they do – and ignore their disclosure obligations to their firms. Neither provides an actionable defense for the culprits.

The purpose of this course is NOT to repeat licensing exam training on specific securities. Rather, it is to remind registered representatives and principals of the terms they previously studied and for which they earned passing scores, as well as the relevant acknowledgements against private securities transactions that most affiliated people sign annually for their firms. These exams and annual compliance forms remind them not to violate Rule 3040 that could result in expensive and publicly reported sanctions – not only for the individuals but also for their supervisors and firms.

As mentioned above, each state Securities Board defines “securities” with its own language. Students are encouraged to research the language of their state. The State of North Carolina uses the following definition:
"Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract including without limitation any investment contract taking the form of a whiskey warehouse receipt or other investment of money in whiskey or malt beverages; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under a title or lease; viatical settlement contract or any fractional or pooled interest in a viatical settlement contract; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.”

Many of these terms were explained in the Series 7 exam, which also provided detailed descriptions of an even lengthier list of securities instruments. The following list can serve as a reminder (the final exam will not test definitions but will include selection among terms).

**Equity securities:** issued, outstanding, treasury stock, no par value, par value, stated value, limited liability, stock certificate, escrow receipt, dividends, stock splits, common and preferred stock, cumulative, participating, convertible, callable, adjustable-rate, rights offering, warrants.

**American Depositary Receipts (ADRs)**

**Direct participation programs (DPPs):** real estate DPPs, oil and gas programs, equipment leasing programs

**Debt instruments:** U.S. Treasury bills, U.S. Treasury notes, U.S. Treasury bonds, Treasury receipts (STRIPS), U.S. government agency securities: Federal Farm Credit Consolidated System wide Bank, Federal Home Loan Bank securities, Student Loan Marketing Association (Sallie Mae) securities, Government agency mortgage-backed securities such as Government National Mortgage Association pass through (GNMAs), Federal National Mortgage Association (FNMA) securities, Federal Home Loan Mortgage Corporation (FHLMC) securities,

**Asset-backed securities**, such as Collateralized Mortgage Obligations (CMOs)

**Corporate bonds:** mortgage bonds, equipment trust certificates, debentures, income bonds (adjustment bonds), guaranteed bonds, convertible bonds.

**Money market instruments:** Repurchase agreements (REPOS), Federal funds, Corporate commercial paper, Negotiable certificates of deposit (CDs), Eurodollars, Eurodollar bonds, Bankers’ acceptances (BAs)
Municipal securities: General obligation (GO) bonds and notes, Revenue bonds, Industrial revenue (industrial development) bonds, Short-term municipal obligations--tax anticipation notes (TANs), bond anticipation notes (BANs), revenue anticipation notes (RANs), project notes (PNs), construction loan notes (CLNs), demand notes (variable-rate demand obligations), tax-exempt commercial paper

Packaged securities: annuities, real estate investment trusts (REITs), Closed-end investment companies, open-end investment companies (mutual funds), Unit investment trusts

Derivative products: Options including: Equity options, Index options, Exchange-traded debt options, yield-based options, Foreign currency options

Retirement products

This is quite a varied list. What do these terms have in common? What might be the simplest definition of a “security?” The common denominator is that someone invests something of value, (usually money, but sometimes “sweat equity” or other assets, like real estate, equipment, or intellectual property) in an enterprise managed by a third party with the expectation of a future increase in the value of the initial investment.

Any transaction involving future delivery of a product or service is riskier than one of immediate transfer. Security transactions are even more risky because they include an expectation, but not a guarantee, of increased value over the intervening time. Naturally, many events may transpire during the period which could undermine that goal.

To inform and protect buyers of securities from unrealistic expectations, therefore, the SEC, FINRA, and other institutions regulate many securities instruments and the people who recommend or sell them. In addition, over the years, FINRA (among other regulatory agencies) has issued many explanatory letters to member firms and their representatives regarding questions about securities. Below is a quote from a (NASD) letter issued in 2001, on a routine securities product:

“There appears to be some uncertainty among associated persons as to whether notes being sold to the public are securities, especially when issuers and marketing agents may insist that they are not. Except for some commercial loans, most notes are securities. A promissory note is most likely a security if the seller is selling notes to the general public to raise money for the general use of a business enterprise and the buyer is lending money as an investment and is interested primarily in the profit that the note is expected to generate.”

What should a well intentioned FINRA registered representative do to stay abreast of financial instruments and terms in our evolving industry? The profession offers many resources. The websites for the SEC (www.sec.gov), FINRA (www.finra.org) and each state’s Security Board are user-friendly and frequently updated. In fact, each FINRA district office has a liaison whom any affiliated person can call with any compliance
related question, including, “Is this a security?” Each Broker-Dealer’s Continuing Education courses are also useful. However, mere recognition of terms is not enough. FINRA registered personnel must also know FINRA’s rules AND their specific firm’s rules REGARDING these terms. (See Lesson 2)

**Summary:**

It is imperative that all people involved in the financial service industry familiarize themselves with terminology involving securities. FINRA presumes familiarity, through its licensing exams, manual, and continuing education requirements, and the public is understandably likely to assume a higher level of knowledge and familiarity among FINRA licensed professionals than among others. However, because of increasingly complex financial transactions, it is understandable that FINRA registered personnel may encounter a product or a deal structure and wonder whether it fits the definition of securities. When in doubt, affiliated personnel have numerous resources to ask. These include their supervisors, compliance officers, their FINRA district office liaison, and securities attorneys, and compliance consulting firms. In addition, each state’s government website (the Securities Division), the SEC website ([www.sec.gov](http://www.sec.gov)), and FINRA’s website ([www.finra.org](http://www.finra.org)) contain useful definitions, warnings to investors and finance professionals, and examples of enforcement actions against those who did not understand the rules.

In general, securities transactions can include a broad variety of equity or debt instruments that are purchased with the expectation, not guaranteed, of future increase in the value invested.
Quiz 1:

1) The following term is NOT commonly associated in a securities transaction:
   a. Mortgage certificate
   b. Collateral trust certificate
   c. Equipment trust certificate
   d. Ownership certificate

2) The following term is NOT commonly associated in a securities transaction:
   a. stock
   b. stock certificate
   c. treasury stock
   d. stock yard

3) The following term is NOT commonly associated in a securities transaction:
   a. Birth certificate
   b. Certificate in a profit sharing pool
   c. Certificate of interest in a lease, title or fee
   d. Pre-organization certificate

4) A securities transaction usually involves which two components:
   I Management by the investor
   II Management by someone other than the investor
   III Unsecured loan
   IV Expectations of increased return
   a. I and III
   b. I and IV
   c. II and III
   d. II and IV

5) Owning 1/100 of a condominium complex is not likely to be a security if a person:
   a. Lives there
   b. Generates rental income
   c. Anticipates a quarterly dividend
   d. Owns shares in the Real Estate Investment Trust

6) Securities laws and language in each state:
   a. Are the same
   b. Vary

7) Definitions of securities are not accessible to the public at:
   a. www.sec.gov
   b. states’ government websites: Securities boards
   c. www.homesecurity.com
d.  www.finra.org

Answer to Quiz 1

1  D
2  D
3  A
4  D
5  A
6  B
7  C
Lesson 2: What does the FINRA Rule 3040 say about private securities transactions?

In this lesson, the student will:
- Analyze the language of Rule 3040
- Apply it to some hypothetical situations
- Recall annual compliance forms required by most Broker-Dealers

Introduction:

Once associated personnel are familiar with the broad range of securities instruments studied in the Series 7 and other licensing exams, they need to review, and their firms need to remind them of, FINRA Rule 3040, which outlines responsibilities regarding any securities transactions to be conducted outside the supervision of the Broker-Dealer.

The terms, “selling away” and “trading away” are shorthand for violating Rule 3040, which governs securities transactions conducted away from one’s Broker-Dealer. The implication of the term is that one should “sell through” or “trade through” FINRA registered firms. Below is the language of that rule. Because the rule is long, its provisions are abbreviated and clarified below, but complete language can be found at [www.finra.org/Manual/Rule 3040](http://www.finra.org/Manual/Rule 3040).

A handy way to remember key points of a detailed documents is to pay attention to “who, what, when, why, where, and how” information. In this case, note who must report what to whom? When? How (In what format)? Why?

FINRA Rule 3040: Private Securities Transactions of an Associated Person

No person associated with a Broker-Dealer shall participate in any manner in a private securities transaction except in accordance with this Rule: Prior to participating in any private security transaction, an associated person shall provide written notice to the Broker-Dealer, describing in detail the proposed transaction and the person’s proposed role and whether selling compensation is expected.

For transactions not involving Compensation, a Broker-Dealer which has received written notice shall provide prompt written acknowledgment and may, at its discretion, require the person to adhere to specified conditions in connection with his participation in the transaction.
For Transactions involving Compensation, a Broker-Dealer which has received notice shall advise the associated person in writing stating whether it approves or disapproves the person's participation in the proposed transaction. If approved, the transaction shall be recorded on the firm's books and records and the firm shall supervise the person's participation as if the transaction were executed on behalf of the firm. If disapproved, the person shall not participate in the transaction in any manner, directly or indirectly.

"Selling compensation" means any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions; finder's fees; securities or rights to acquire securities; rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise; or expense reimbursements.

Let’s review the rule by asking and answering “who, what, when, how, why” questions.

Q: WHO must report what to WHOM?

A: Everyone affiliated with a Broker-Dealer must report private securities transactions to the Broker-Dealer.

Note the unequivocal wording in the first paragraph: “NO person associated with a Broker-Dealer shall participate in ANY manner in a private securities transaction WITHOUT written notice to the Broker-Dealer.”

Q HOW shall this notification be given?

A. The rule requires WRITTEN notification, by both the affiliated person and, in response, by the Broker-Dealer. Note the consistent wording: “WRITTEN notice to the Broker-Dealer”; “a Broker-Dealer which has received WRITTEN notice shall provide prompt written acknowledgment;” “a Broker-Dealer which has received notice shall advise the associated person IN WRITING stating whether it approves or disapproves.”

Q. WHEN shall notice be given?

A. By the affiliated person, notice needs to be given in ADVANCE of engaging in the activity. By the firm, the rule simply requires a “prompt” response.

Note the wording, “No person…SHALL participate ...without written notice...(of) the PROPOSED transaction,” and also “PRIOR to participating in ANY... transaction…” Together, these words clearly state that affiliated people need to inform their Broker-Dealer BEFORE they engage in a private securities transaction, or, if already engaged in a transaction before applying to a Broker-Dealer, discuss it up front, before joining.

Q: WHY should an applicant discuss private affairs in advance of affiliation?
A: FINRA allows each firm to make its own discretionary decisions and requirements about the outside activities — securities or otherwise — of its registered personnel. Therefore, people who change firms should NOT assume that private securities transaction allowed by a prior firm will be approved by another. There is no such thing as “grandfathered” approvals across the industry. Note the language of the second paragraph regarding non-compensated transactions:

“a Broker-Dealer which has received written notice … may, at its discretion, require the person to adhere to specified conditions.”

Further, note the language regarding compensated transactions: “a Broker-Dealer which has received notice shall advise the associated person in writing stating whether it approves or disapproves the person's participation in the proposed transaction….IF DISAPPROVED, the person shall NOT participate in the transaction in ANY manner.”

Note the following language: If approved, the transaction shall be recorded on the firm’s books and records and the firm shall supervise the person’s participation as if the transaction were executed on behalf of the firm.

Q: Why would a Broker-Dealer care whether its affiliated people provide free securities related services or accept a nominal finder’s fee?

A: There may be several reasons.

1) **Lost opportunity cost.** Management may regard time spent on a free project as undermining revenue generation for the firm or that the free service was one the firm could have offered, for a fee.

2) **Trilateral fiduciary duty:** According to FINRA’s Code of Ethics, Every affiliated person has three duties of disclosure: a) to the firm, b) to the client company or customer and c) to the investing public. Disclosure of personal interest, such as a private securities transaction, is a rather obvious part of that duty.

3) **Liability** for the firm: In our litigious society, a dissatisfied client of a registered representative may level a complaint or suit against the Broker-Dealer. FINRA’s presumption of supervision reflects the public’s similar presumption. Since a firm can be held liable for supervision of securities related services performed by its registered people, it has the right and responsibility to determine which projects it wants to supervise and which it does not.

4) **Limited Scope:** Broker-Dealers, just like registered personnel, are limited by FINRA as to what sorts of securities businesses they can conduct. Some have approval to trade public stocks, while others can conduct only Private Placements. A Broker-Dealer not authorized to sell options, for example, would lack the approvals to supervise an affiliated person who wished to do privately.

For these and other reasons that vary from firm to firm, it is within the purview of the Broker-Dealer, not the registered representative, to determine whether a private securities transaction is permissible or not.
Note: Lost opportunity cost and disclosures of personal interests apply to the logic of adjacent Rule 3030, which states that outside business activities of any kind must also be reported to a Broker-Dealer. Thus, even if a person is honestly ignorant that her outside sale is a security, she STILL should have asked permission, because she is required to report outside business activities.

Further Note: The public may understandably assume that FINRA affiliated people are, by virtue of their licenses and professional experience, more knowledgeable than others about the risks and rewards of various forms of securities, and may ask them for free or paid help. Affiliated personnel should not worry about saying “No” to friends, relatives, and business colleagues until they have conferred with their supervisors. MOST professional associations (doctors, accountants, lawyers, engineers etc) have similar rules against moonlighting without approval. Therefore, many people can easily understand why a registered person has to seek approval from a registered firm and may have to decline.

Summary:

All people affiliated with a Broker-Dealer (FINRA member) are required to report to their supervisor in writing, in advance of any private securities transaction in which they wish to engage, whether or not they anticipate any compensation. Each firm has discretion to decide whether or not to approve such projects, and should respond promptly, in writing. Compensated projects MUST be conducted with the full supervision of the firm, effectively negating the “private” aspect altogether. There are many reasons why a firm may choose to reject any or all private securities transactions, including their own ability to conduct and supervise various securities transactions, liability, and lost opportunity costs.
Quiz 2

1) FINRA Rule 3040 addresses:
   a. Outside business activities
   b. Private security transactions
   c. Private brokerage statements
   d. Moonlighting

2) Rule 3040 does NOT address:
   a. Where to report
   b. When to report
   c. Who should report
   d. How to report

3) Individual Broker- Dealers may vary in what they do and don’t approve because:
   a. The SEC grants them discretion
   b. Each state grants them discretion
   c. FINRA grants them discretion
   d. Security attorneys grant them discretion

4) Which of the following is NOT a reason why Broker- Dealers may vary in their approvals of private security transactions?
   a. They may or may not want the liability
   b. They may or may not be authorized by FINRA to supervise particular securities transactions
   c. They may or may not want their employees spending time on outside jobs
   d. They may or may not have an authorized ratio of registered principals (Series 24 licenses) to representatives (Series 7s)

5) Edna Entrepreneur had received written approval from a prior Broker- Dealer for involvement in her family’s business, which is expanding through private placements of securities placed with accredited individuals. Presuming that such approval applies across the industry, she doesn’t mention the current offering to the firm at which she is applying or the fact that friends have asked her to advise them on their private offerings. Which of the following is NOT a mistake of hers?
   a. Assuming that approvals from one Broker-Dealer transfer to another
   b. Neglecting to mention outside business activities of any kind
   c. Receiving Broker-Dealer approval in writing
   d. Privately advising others on securities transactions without notifying the Broker-Dealer.
6) Which of the following is not a realistic reason why firms vary on private securities transaction approvals?

a. A firm may not be approved by FINRA to supervise the sort of securities transaction a registered person wants to undertake.
b. A firm may be approved to conduct the very security transaction that a registered person wants to conduct privately, and may consequently wish to bring such projects in as paying business.
c. A firm may not want the liability of supervising a project that an affiliated person explicitly wishes to conduct outside the Broker-Dealer.
d. A firm may allow only people in one branch office to conduct private securities transactions but not in another.

7) The terms, “trading away” and “selling away” mean:

a. Changing Broker-Dealers
b. Leaving a registered firm for an unregistered one
c. Selling securities outside of one’s Broker-Dealer
d. Selling securities from one’s personal portfolio
Answers to Quiz 2:

1 B
2 A
3 C
4 D
5 C
6 D
7 C
Lesson 3: FINRA Sanctions for Private Securities Transactions

This lesson includes:

- Samples of FINRA sanctions against affiliated personnel who violated Rule 3040 (private securities transactions)
- FINRA guidelines regarding the range of sanctions

Introduction:

FINRA regards unreported or disallowed private securities transactions as so serious a violation, particularly with the clarity of Rule 3040 and the documents that all affiliated personnel sign each year, that a high proportion of violators are barred from the industry. Those violators who fail to comply with a firm or FINRA investigation are especially likely to be ejected. However, FINRA considers a range of factors in each case, resulting in range of penalties. Below are five real sanctions drawn from the monthly reports publicly available at www.finra.org. In the examples below, some descriptions have been abbreviated and the names and CRD numbers have been deleted. Note the range of penalties, which include fines, suspensions, and industry bars.

- **Registered Representative, Dallas, TX** was barred from FINRA for engaging in a private securities transaction without providing prior written notice to her firm, and failing to comply with FINRA requests for information.

- **Registered Representative in Arlington, TN** engaged in private securities transactions without prior written notice to, and approval from, his member firm. He knowingly or recklessly made material misrepresentations to public customers in connection with a real estate entity/fund and failed to respond to FINRA requests for information.

- **Registered Principal, Omaha, Nebraska** submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, he consented to the described sanction and to the entry of findings that, while selling notes relating to an entity he controlled, he failed to disclose to investors that funds from new investors were being used to pay earlier investors. The findings stated that he did not disclose in writing to his member firm that he was selling the notes to investors, and his member firm did not provide written approval for him to do so. The findings also stated that he failed to respond to FINRA requests for information.
• **Registered Representative, South Lyon, Michigan** submitted a Letter of Acceptance, Waiver and Consent in which he was fined $5,000 and suspended from association with any FINRA member in any capacity for four months. Without admitting or denying the findings, he consented to the described sanctions and to the entry of findings that he engaged in private securities transactions and failed to give written notice of his intention to participate in the proposed transactions and to receive written acknowledgement of said notice.

• **Registered Representative, Troy, Michigan** submitted an Offer of Settlement in which he was suspended from association with any FINRA member in any capacity for one year and ordered to pay $905,000, plus interest, in restitution to public customers. Without admitting or denying the allegations, he consented to the described sanctions and to the entry of findings that he engaged in private securities transactions and failed to give written notice to, and receive written acknowledgement from, his member firm.

Sanctions for Rule 3040 violations can include monetary penalties of $5,000 to 50,000 and suspensions up to two years or a permanent industry bar.

Within this range, what are FINRA’s Guidelines (posted at [www.finra.org](http://www.finra.org)) for determining whether a particular case warrants a lighter or more severe penalty? “Who, what, when, how” questions help organize the relevant factors. (“Where” isn’t pertinent).

**HOW MUCH?**
The dollar volume of private securities sales influences the suspension length:
- Below $100,000: up to 3 months suspension
- Below $500,000: up to 6 months suspension
- Below $1,000,000: up to 1 year’s suspension
- Over $1,000,000: 12 months’ suspension to an industry bar

The dollar value of harm incurred by the customers

**HOW MANY?**
The number of customers
The number of transactions
The duration of the activities

**WHO?**
Were the private securities customers also customers of the Broker-Dealer?
Were other representatives of the firm recruited to participate, too?

**WHAT?**
Were any federal or state securities laws broken? (such as fraud)
What disclosures did the person make to investors?
Any beneficial interest in the product or company by the sales person?
Any erroneous impression that the sale was approved by the Broker-Dealer?
What notification did the person give to the Broker-Dealer?
  Was it written? Was it accurate or misleading?
  What response did the person receive from the Broker-Dealer?
  Written? Approved or Disapproved? Any requirements?
What is the person’s compliance record?
What other infractions occurred, besides Rule 3040 violations?

Given these guidelines, a reader can infer factors that contribute to higher or lower penalties. Obviously, an affiliated person who never notified the firm at all, who surreptitiously recruited other representatives to conduct numerous private securities transactions involving a high dollar amount that hurt customers of the Broker-Dealer would generate a harsh sentence. Someone else found to participate in one incident, who, once reprimanded and retrained by supervisors, implements corrective action and, if appropriate, paid restitution to those harmed, might net a lighter sanction.

FINRA scrutinizes not only the offending party, but also the firm’s supervisory processes. If these fail to meet industry expectations, the firm and its supervisory personnel can be sanctioned for negligence or complicity. For example, if an affiliated person DID give written notice of a private securities transaction but never received a written response, the firm itself can be fined $2500 - $10,000 and the supervisor can be suspended for up to 2 years.

FINRA evaluates the disciplinary history of both the individual and the firm, the quality of the firm’s training, supervision, and written supervisory procedures, the timing and extent of corrective measures taken by the individual AND the firm (before or after a FINRA audit or Enforcement Hearing). Finally, FINRA considers whether the individual engaged in a private securities transaction in good faith, after relying on advice of industry knowledgeable advisors, such as securities attorneys or compliance consultants.

Summary:
FINRA regards very seriously private securities transactions by personnel affiliated with Broker-Dealers. Fines can be levied against both the individuals (up to $50,000) and their negligent supervisors and firms (up to $10,000). Suspensions, usually determined by the sales volume, can extend as long as two years. FINRA bars from associating with any other FINRA firm those individuals who engage in particularly egregious cases of repeat behavior, deception, high sales volume, numerous private customers, or refusal to participate in the inquiry. Individual factors, such as a person’s compliance record or a firm’s supervisory procedures can impact the final penalty.
Lesson 3 Quiz (6)

1) The financial penalties for an individual range between:
I $1000
II $5,000
III $25,000
IV $50,000
a. I – II  
b. II- III  
c. I-III  
d. II-IV

2) The financial penalty for a negligent supervisor or firm under whom someone violated Rule 3040’s private securities limitations range between:
I $1000
II $2500
III $5000
IV $10,000
a. I-II  
b. III-III  
c. I-III  
d. II-IV

3) The volume of private sales primarily impacts:
   a. The fine  
b. The suspension  
c. Both  
d. Neither

4) Private securities transactions valued at less than $100,000 can result in a suspension up to:
   a. 1 month  
b. 3 months  
c. 6 months  
d. 1 year

5) Which of the following is NOT a factor that could result in a lower FINRA sanction:
   a. Did provide written notification and received no written response  
b. Did provide written notification and received a written letter of disapproval  
c. Paid restitution to harmed customers  
d. Implemented corrective action before an Enforcement Hearing
6) In the cases that resulted in banishment from the industry, what factor did they the summaries reveal that they all had in common?

   a. Customers of the Broker-Dealer  
   b. High dollar volume  
   c. Repeat offenses  
   d. Failure to comply with the FINRA investigation
Answer to Quiz 3
1 D
2 D
3 B
4 D
5 B
6 D