

Registration and Qualification Requirements for Certain Operations Personnel

FINRA Requests Comment on Proposed Registration Category, Qualification Examination and Continuing Education Requirements for Operations Professionals

Comment Period Expires: July 12, 2010

Executive Summary

FINRA requests comment on a proposal to establish a registration category, qualification examination and continuing education requirements for certain operations personnel. The proposal would expand FINRA's registration requirements to include as qualified and registered persons certain individuals who are engaged in, or supervising, activities relating to sales and trading support and the handling of customer assets to enhance the regulatory structure surrounding a member firm's back-office operations. As further detailed in this *Notice*, the proposed Operations Professional registration category generally is aimed at capturing those persons with decision-making and/or oversight authority in direct furtherance of the covered operations functions. Persons required to register under this proposal also would be subject to FINRA's continuing education requirements.

The text of the proposed rules is set forth in Attachment A.

Questions regarding this *Notice* should be directed to:

- ▶ Joe McDonald, Director, Testing and Continuing Education Department, at (240) 386-5065; or
- ▶ Erika L. Lazar, Counsel, Office of General Counsel, at (202) 728-8013.

May 2010

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Registration
- ▶ Senior Management

Key Topics

- ▶ Continuing Education
- ▶ Examination
- ▶ Qualification
- ▶ Registration
- ▶ Representative

Referenced Rules & Notices

- ▶ FINRA Rule 8310
- ▶ NASD Rule 1021
- ▶ NASD Rule 1031
- ▶ NASD Rule 1120
- ▶ Incorporated NYSE Rule 345.10
- ▶ Information Notice 03/12/08
- ▶ Information Notice 10/06/08
- ▶ Regulatory Notice 08-57

Action Requested

FINRA encourages all interested parties to comment on the proposed rules. Comments must be received by July 12, 2010.

Firms and other interested parties can submit their comments using the following methods:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

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

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this Notice will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.¹

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.²

I. Background

Given the growing complexity of the financial services industry and the importance of services provided by a firm's so-called "back-office" personnel, FINRA has concerns about the potential for regulatory gaps in the area of licensing and education requirements for individuals performing operations functions. Historically, federal and state law and self-regulatory organization rules, including NASD Rules 1021 and 1031, have required that individuals engaged in or supervising the securities or investment banking business of a member firm be qualified and registered persons. These requirements generally have applied to, among others, individuals with customer contact providing advice (sales persons and investment bankers) or effecting securities transactions (traders), and their supervisors. However, unregistered individuals who perform operations functions within a member firm also play an integral role in the business of the firm, and their activities often have a meaningful connection to client funds, accounts and transactions.

II. Proposal

FINRA believes that licensing and education requirements for certain operations personnel are needed to help ensure that investor protection mechanisms are in place in all areas of a member firm's business that could harm a customer, a firm, the integrity of the marketplace or the public. Accordingly, FINRA proposes expanding its registration requirements to include as qualified and registered persons certain individuals (as further detailed in Section II.A. below) who are engaged in, or supervising, activities relating to sales and trading support and the handling of customer assets (Operations Professionals) to enhance the regulatory structure surrounding a firm's back-office operations.

A. Depth of Personnel Included in the New Registration Category

Generally, the proposed registration category for Operations Professionals is aimed at capturing those persons with decision-making and/or oversight authority in direct furtherance of the covered operations functions, which are described in detail in Section II.B. below (the covered functions). Persons subject to the new registration category generally are those persons who are directly responsible for overseeing that tasks within the covered functions are performed correctly in accordance with industry rules, firm protocols, policies and procedures, and who are charged with protecting the functional and control integrity of the covered functions for the firm.

More specifically, the following persons would be required to register with FINRA as an Operations Professional (collectively, covered persons):

- (1) Senior management with responsibility over the covered functions;
- (2) Supervisors, managers or other persons responsible for approving or authorizing work in direct furtherance of the covered functions, including work of other persons in the covered functions;
- (3) Persons with the authority or discretion to commit the firm's capital in direct furtherance of the covered functions or to commit the firm to any contract or agreement (written or oral) in direct furtherance of the covered functions (including, *e.g.*, a person who has the discretion to commit the firm to any contract or agreement involving securities lending or borrowing activities).

The requirements would not apply to persons who perform a covered function, but whose responsibilities are below these three specified levels, or persons who perform a function ancillary to a covered function or whose function is to serve a role that can be viewed as supportive of, or advisory to, the performance of a covered function, such as internal audit, legal or compliance personnel. Also, the requirements would not apply to persons who are engaged solely in clerical or ministerial activities in any of the covered functions.

Importantly, those persons subject to the new Operations Professional registration category would be considered associated persons of a firm irrespective of their employing entity and would be subject to all FINRA rules applicable to associated persons and/or registered persons.³

To implement this proposal, FINRA is proposing amendments to proposed FINRA Rule 1230 (Registration Categories) to add a new representative registration category for Operations Professionals.⁴ Also, in light of the fact that the Operations Professional registration category would encompass individuals engaged in or supervising stock loan/securities lending activities, the proposed registration categories for a “Securities Lending Representative” and a “Securities Lending Supervisor” would be eliminated.⁵

B. Functions for Inclusion in the New Registration Category

The three categories of persons identified in Section II.A. above that conduct activities or functions for the firm in one or more of the following covered functions would be required to register as an Operations Professional:

- Development and approval of pricing models used for valuations;
- Trade confirmation, account statements, settlement, margin;
- Stock loan/securities lending;
- Prime brokerage (services to other broker-dealers and financial institutions);
- Client on-boarding (customer account data and document maintenance);
- Capturing of business requirements for sales and trading systems and any other systems related to the covered functions, and validation that these systems meet such business requirements;
- With respect to the covered functions, defining and approving business security requirements and policies for information technology (including, but not limited to, systems and data);
- Defining information entitlement policy in connection with the covered functions;
- Financial Controller (including general ledger);
- Collection, maintenance, re-investment (*i.e.*, sweeps) and disbursement of funds;
- Bank, custody, depository and firm account management and reconciliation;
- Segregation, possession and control, fail control, buy ins;
- Receipt and delivery of securities and funds, account transfers;
- Financial regulatory reporting; and
- Posting entries to the books and records of a firm in connection with the covered functions.

C. Operations Professional Qualification Examination

FINRA proposes the establishment of a new qualification examination for Operations Professionals that would provide reasonable assurance that such individuals understand their professional responsibilities, including key regulatory and control themes, as well as the importance of identifying and escalating red flags that may harm a firm, its customers, the integrity of the marketplace or the public. The SEC staff has previously indicated its support for the establishment of a qualification examination for covered persons to heighten their awareness of operating in a regulated environment and to demonstrate a basic understanding of the securities industry.

In general, given the diversity of functions performed by covered persons, FINRA proposes the development of a single principles-based qualification examination with a regulatory focus to test for a broad understanding of a broker-dealer's business at a basic level; a basic understanding of the operations functions that support a broker-dealer's business; and the regulations designed to achieve investor protection and market integrity that drive the operations processes and procedures conducted at a broker-dealer. Any individual whose activities go beyond those proposed for the Operations Professional registration category would be required to separately qualify and register in the appropriate category or categories of registration attendant to such activities.

The proposed Operations Professional qualification examination is not intended to be a competency examination, but would test for general securities industry knowledge with a regulatory focus to alert such persons that they are functioning in a heavily regulated industry. The continuing education components associated with the Operations Professional registration category (described in detail in Section II.E. below) would provide competency training specific to the covered functions.

The breadth and depth of coverage of the qualification examination would be determined through the use of testing industry standards used to develop examinations, and would include input and advice from covered persons active in the securities industry.

The following are the three key content themes of the new Operations Professional qualification examination:

- ▶ **Professional Conduct and Ethical Considerations:** This section of the examination would assess a candidate's core knowledge addressed on other FINRA examinations that is appropriate for the Operations Professional. The questions in this section would assess knowledge of what are considered serious violations of securities industry rules. This category would include ethics-based questions that address issues such as data integrity, escalation of regulatory red flags and separation of duties.

- ▶ **Essential Product and Market Knowledge for an Operations Professional:** This section of the examination would assess a candidate's basic product and market knowledge, including definitions and characteristics of major product categories (*i.e.*, equities, debt, packaged securities, options and markets). The Operations Professional would not be expected to know the same level of detail about the products and markets as a product specialist or a representative selling products to customers.
- ▶ **Knowledge Associated With Operations Activities:** This section of the examination would assess a candidate's broad-based knowledge regarding the covered functions outlined above that support a broker-dealer's business, and the underlying rules that drive the processes associated with these activities (*i.e.*, customer account set-up and transfers, recordkeeping requirements, rules associated with the protection of customer assets and transaction processing, uniform practices associated with making good delivery of securities, making payments for securities and meeting settlement requirements, credit and margin rules, and how to obtain supervisory approval for any of the above).

D. Exception to Operations Professional Examination Requirement

FINRA is proposing an exception to the Operations Professional qualification examination requirement for persons who currently hold certain registrations (each an eligible registration) or have held one during the two years immediately prior to registering as an Operations Professional. The proposed exception also would apply to persons who do not hold an eligible registration, but prefer an alternative to taking the Operations Professional examination. Such persons would be permitted to register in an eligible registration category (subject to passing the corresponding qualification examination or obtaining a waiver) and use such registration to qualify for Operations Professional registration.

A person who wishes to obtain Operations Professional registration under the proposed exception would not be automatically waived-in, but would have to opt-in by requesting Operations Professional registration via Form U4 (the Uniform Application for Securities Industry Registration or Transfer) in the Central Registration Depository (CRD®).⁶ If there are no other deficiencies (funds, fingerprints, etc.), the Operations Professional registration would be approved automatically at the time such request is made. (*See also* Section II.F. below regarding the transition period and implementation date.) FINRA would not assess a separate registration fee for persons relying on the proposed exception to register as Operations Professionals.

FINRA conducted a review of the content outlines for each qualification examination it recognizes and identified examinations with broad content coverage that would be eligible for an exception to the Operations Professional examination requirement.

Accordingly, persons that hold the following representative level registration categories, or who have held such registration categories within the two years immediately prior to registering as an Operations Professional, would be qualified to register as an Operations Professional without passing the Operations Professional qualification examination:

- Investment Company Products/Variable Contracts Representative (Series 6)
- General Securities Representative (Series 7)
- United Kingdom Securities Representative (Series 17) or Canada Securities Representative (Series 37 or 38)

Additionally, persons who hold (or have held) certain principal-level registration categories would be qualified to register as an Operations Professional without passing the Operations Professional examination. Most principal-level qualification examinations have a prerequisite examination requirement that is satisfied with one of the representative qualification examinations listed above; however, FINRA also proposes to include principal-level qualification examinations that do not have a prerequisite, or that have a prerequisite that can be met with a qualification examination not on the above list (*e.g.*, Series 62), because it is likely that such principals are familiar with the content to be covered in the Operations Professional qualification examination as a result of the requirements of their positions.

Accordingly, persons who hold the following principal-level registration categories, or who have held such registration categories within the two years immediately prior to registering as an Operations Professional, would be qualified to register as an Operations Professional without passing the Operations Professional qualification examination:

- Registered Options Principal (Series 4)
- General Securities Sales Supervisor (Series 9/10)
- Compliance Officer (Series 14)
- Supervisory Analyst (Series 16)
- General Securities Principal – Sales Supervisor (Series 23)
- General Securities Principal (Series 24)
- Investment Company Products/Variable Products Principal (Series 26)
- Financial and Operations Principal (Series 27)
- Introducing Broker/Dealer Financial and Operations Principal (Series 28)
- Municipal Fund Securities Limited Principal (Series 51)
- Municipal Securities Principal (Series 53)

The proposed exception would not apply to persons whose eligible registrations have been revoked or terminated pursuant to FINRA Rule 8310 (Sanctions for Violations of the Rules) within the two years immediately prior to registering as an Operations Professional.

FINRA notes that operations personnel who would be subject to the Operations Professional registration requirements are generally acting in a supervisory position, so many persons will already hold one of the eligible registrations that would qualify for the exception to the Operations Professional examination requirement. As noted above, entry-level operations personnel would not typically be subject to the proposed requirements for Operations Professionals.

E. Continuing Education Requirements for Operations Professionals

FINRA would require that individuals registered as Operations Professionals be subject to FINRA's Regulatory Element and Firm Element continuing education requirements as set forth in NASD Rule 1120 (Continuing Education Requirements). The continuing education elements for this registration category would provide learning materials appropriate for Operations Professionals, given the breadth of functions that are covered by this registration requirement.

The Regulatory Element program for Operations Professionals would provide instruction for Operations Professionals to:

- (1) maintain and improve understanding of the regulatory and ethical aspects associated with the covered functions;
- (2) identify suspicious activities and/or red flags that could harm a customer, a firm, issuers of securities or the integrity of the marketplace;
- (3) maintain and improve knowledge and understanding of the covered functions; and
- (4) assist the Operations Professionals in keeping up with changes in the industry and regulations that impact their work.

Operations Professionals would be required to complete scenario-based modules based on the key content themes of the Operations Professional qualification examination, as described in Section II.C. above. The breadth and depth of coverage of the modules would be determined through the use of existing industry standards currently used to develop continuing education content and would include input and advice from operations professionals active in the securities industry. Individuals would be expected to complete the Regulatory Element continuing education requirement two years after passing the qualification examination and then every three years thereafter. FINRA expects that the continuing education content for Operations Professionals would be available two years after the launch of the qualification examination.

Individuals who avail themselves of the proposed exception to the Operations Professional qualification examination requirement with an eligible registration (described in Section II.D. above) would be subject to the Regulatory Element program

appropriate for such other registration category. For example, a person who registers as an Operations Professional by holding a General Securities Representative registration under the exception would be subject to the S101 continuing education program.

Operations Professionals would also be subject to Firm Element training. To implement this change, FINRA would expand NASD Rule 1120(b) to include Operations Professionals in the definition of “covered registered persons,” and to require that firms deliver Firm Element training to Operations Professionals subject to the new registration and qualification requirements.⁷

F. Transition Period and Implementation Date

1. Persons Acting as Operations Professionals as of the Effective Date of the New Registration Requirement

FINRA is proposing a six- to nine-month transition period for existing personnel that meet the depth of personnel criteria and are engaged in the covered functions as of the effective date of the proposed registration category. During this six- to nine-month period (which would begin on the date the proposed registration category takes effect), covered persons would be required to register with FINRA as Operations Professionals. FINRA believes that a six- to nine-month transition period will provide firms with an opportunity to identify persons who would be subject to the Operations Professional requirements, and provide such covered persons an opportunity to register as an Operations Professional by doing one of the following, as applicable:

- (1) requesting Operations Professional registration via Form U4 in CRD and passing the Operations Professional qualification examination;
- (2) requesting Operations Professional registration via Form U4 in CRD pursuant to the proposed exception, based on their holding, or having held within the past two years, an eligible registration (*see* Section II.D. above);⁸ or
- (3) registering with FINRA in one of the eligible registrations and, pursuant to the proposed exception (*see* Section II.D. above), requesting Operations Professional registration via Form U4 in CRD.

2. Persons Who Begin Work as Operations Professionals Following the Effective Date of the New Registration Requirement

The six- to nine-month transition period would not apply to persons who meet the depth of coverage criteria and begin work in the covered functions *following* the effective date of the proposed registration category (*i.e.*, new hires or existing associated persons who transition into the covered functions). Such persons would be required to register as an Operations Professional *prior to engaging in* any of the activities that would qualify them as covered persons, regardless of whether they begin work during the transition period or after it expires, and would be permitted to register as described in paragraphs (1) – (3) of Section II.F.1. above.

Endnotes

- 1 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) (NASD Announces Online Availability of Comments) for more information.
- 2 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See SEA Section 19 and rules thereunder.
- 3 *See Notice to Members 05-48* (Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers). The *Notice* reminds members that "in the absence of specific NASD [or FINRA] rules, MSRB rules, or federal securities laws or regulations that contemplate an arrangement between members and other registered broker-dealers with respect to such activities or functions (e.g., clearing agreements executed pursuant to NASD Rule 3230), any third-party service providers conducting activities or functions that require registration and qualification under NASD [or FINRA] rules will generally be considered associated persons of the member and be required to have all necessary registrations and qualifications."
- 4 *See Regulatory Notice 09-70* (FINRA Requests Comment on Proposed Consolidated FINRA Rules Governing Registration and Qualification Requirements). The proposed amendments discussed in this *Notice* would be included in proposed FINRA Rule 1230 (Registration Categories).
- 5 *See supra* note 4. In *Regulatory Notice 09-70*, FINRA proposed generally adopting the NYSE registration requirement for securities lending representatives and securities lending supervisors (Incorporated NYSE Rule 345.10), which requires the registration of securities lending representatives and their direct supervisors. Under NYSE rules, such persons are not subject to any training or examination requirements; however, these individuals are required to file a Form U4 and sign a "code of ethics" agreement.
- 6 A person who qualifies for the proposed exception based on their having held an eligible registration within the two years immediately prior to registering as an Operations Professional would be required to first re-activate such eligible registration prior to requesting Operations Professional registration.
- 7 NASD Rule 1120 (Continuing Education Requirements) is limited to registered persons who have *direct contact with customers* in the conduct of the firm's securities sales, trading and investment banking activities, any person registered as a research analyst pursuant to Rule 1050, and to the immediate supervisors of such persons. The proposed amendments would be included in the new FINRA rule governing continuing education, FINRA Rule 1250, which would be filed concurrently with this proposal.
- 8 *See supra* note 6.
- 9 This would include, for example, a person who takes and passes the Series 7 examination, or qualifies for a waiver of the requirement to take the examination, and registers in CRD as a General Securities Representative.

ATTACHMENT A

Below is the text of the proposed rule change. Proposed new language is underlined.

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Text of Proposed New FINRA Rule

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1200. REGISTRATION AND QUALIFICATION

1230. Registration Categories

(a) Definition of Principal and Principal Registration Categories

(1) through (11) Reserved.

(b) Definition of Representative and Representative Registration Categories

(1) through (5) Reserved.

(6) Operations Professional

(A) Requirement

Each of the following persons shall be required to register with FINRA as an Operations Professional:

(i) Senior management with responsibility over the covered functions in paragraph (b)(6)(B) of this Rule;

(ii) Supervisors, managers or other persons responsible for approving or authorizing work in direct furtherance of the covered functions in paragraph (b)(6)(B) of this Rule, including work of other persons in the covered functions in paragraph (b)(6)(B) of this Rule; and

(iii) Persons with the authority or discretion to commit the member's capital in direct furtherance of the covered functions in paragraph (b)(6)(B) of this Rule or to commit the member to any contract or agreement (written or oral) in direct furtherance of the covered functions in paragraph (b)(6)(B) of this Rule.

(B) Covered Functions

- (i) Development and approval of pricing models used for valuations;
- (ii) Trade confirmation, account statements, settlement, margin;
- (iii) Stock loan/securities lending;
- (iv) Prime brokerage (services to other broker-dealers and financial institutions);
- (v) Client on-boarding (customer account data and document maintenance);
- (vi) Capturing of business requirements for sales and trading systems and any other systems related to the covered functions, and validation that these systems meet such business requirements;
- (vii) With respect to the covered functions, defining and approving business security requirements and policies for information technology (including, but not limited to, systems and data);
- (viii) Defining information entitlement policy in connection with the covered functions;
- (ix) Financial Controller (including general ledger);
- (x) Collection, maintenance, re-investment (i.e., sweeps) and disbursement of funds;
- (xi) Bank, custody, depository and firm account management and reconciliation;
- (xii) Segregation, possession and control, fail control, buy ins;
- (xiii) Receipt and delivery of securities and funds, account transfers;
- (xiv) Financial regulatory reporting; and
- (xv) Posting entries to the books and records of a member in connection with the covered functions.

(C) Qualification Examination

Subject to the exception in paragraph (b)(6)(D) of this Rule, any person who is required to register as an Operations Professional shall pass the Operations Professional qualification examination before such registration may become effective.

(D) Exception

Any person who is registered with FINRA as an Investment Company Products/Variable Contracts Representative, General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative, Registered Options Principal, General Securities Sales Supervisor, Compliance Officer, Supervisory Analyst, General Securities Principal – Sales Supervisor, General Securities Principal, Investment Company Products/Variable Products Principal, Financial and Operations Principal, Introducing Broker/Dealer Financial and Operations Principal, Municipal Fund Securities Limited Principal or Municipal Securities Principal, and any person who has been registered in one of these categories within the two years immediately prior to registering as an Operations Professional, shall be qualified to register as an Operations Professional without passing the Operations Professional qualification examination, provided that such registration has not been terminated or revoked pursuant to FINRA Rule 8310.

(E) Implementation

Any person who is required to register as an Operations Professional under this Rule as of [insert the effective date of the rule] shall register as an Operations Professional within the time period prescribed by FINRA for such persons. Any person who is not required to register as an Operations Professional under this Rule as of [insert the effective date of the rule] shall register as an Operations Professional prior to engaging in any activities that would require such registration.

(7) through (13) Reserved.

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1250. Continuing Education Requirements

(a) Reserved.

(b) Firm Element

(1) Persons Subject to the Firm Element

The requirements of this subparagraph shall apply to any person registered with a member who has direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, any person registered as an operations professional, any person registered as a research analyst or a supervisory analyst and the immediate supervisors of such persons (collectively, "covered registered persons"). "Customer" shall mean any natural person and any organization, other than another broker or dealer, executing securities transactions with or through or receiving investment banking services from a member.

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