

FINRA Adopts New Registration Requirement for Operations Professionals

In Regulatory Notice 11-33 (July 2011), the Financial Industry Regulatory Authority ("FINRA") announced approval by the Securities and Exchange Commission ("SEC") of new FINRA Rule 1230(b)(6) (the "Rule") to establish registration, examination and continuing education requirements for "Operations Professionals" associated with a broker-dealer.¹ While the Rule will affect all FINRA member broker-dealers, its practical effect may be minimal for broker-dealers that are engaged in limited businesses, do not handle customer money or securities or do not have significant back office operations. The Rule will take effect on October 17, 2011, although designation as an Operations Professional is not required until December 16, 2011 and completion of the examination requirement is not required until October 17, 2012. Persons who hold or have held certain registered representative-level (e.g., Series 6 or 7) or principal-level (e.g., Series 24, 26 or 27) registrations may be eligible to register as an

Operations Professional without completing the new examination requirement.

Although FINRA's registration regime historically focused on "front office" personnel who have contact with customers or are otherwise directly involved in effecting securities transactions, previously unregistered persons who perform "back office" functions, such as recordkeeping, trade confirmation, transaction settlement, internal auditing and securities lending operations are the focus of the Rule. With the adoption of the Rule, broker-dealers can expect to face greater scrutiny from FINRA with regard to the member's "back office" functions and supervision. In approving FINRA's proposal, the SEC stated that requiring Operations Professionals to register with FINRA "will help to address regulatory gaps in this area."

Covered Persons and Functions

The Rule requires any Covered Person (as defined below) to register with FINRA as an Operations Professional, regardless of whether such person is employed by the broker-dealer, an affiliate or third-party service provider. Covered Persons may be "front-office" or "back-office" personnel and there are no categorical exclusions from the Rule based on job titles or departments.² The Rule does not

¹ FINRA filed a proposed rule change with the SEC on March 4, 2011. The proposed rule change was published for comment in the Federal Register on March 18, 2011. See Securities Exchange Act Release No. 64080 (March 14, 2011), 76 FR 15012 (March 18, 2011). The Commission received 17 comment letters on the proposed rule change. On June 15, 2011, the SEC received from FINRA a Response to Comments and Partial Amendment No. 1 to the proposed rule change (the "FINRA Response Letter"). On June 16, 2011, the SEC published a notice and order to solicit comment on Amendment No. 1 and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis. See Securities Exchange Act Release No. 34-64687 (June 16, 2011), 76 FR 36586 (June 22, 2011) (the "SEC Release"). On July 22, 2011, FINRA published Regulatory Notice 11-33 (July 2011) which discusses the adoption and implementation of the Rule.

² For example, the SEC Release contemplates that managers and supervisors within a broker-dealer's information technology ("IT") department may be required to register as Operations Professionals, although FINRA indicated it would not expect entire IT departments to be required to register pursuant to the Rule.

alter the definition of an “associated person;” rather, it imposes new registration, qualification examination and continuing education requirements on those associated persons who meet the Covered Person criteria as they are, in FINRA’s determination, performing regulated broker-dealer functions on behalf of a FINRA member.

Covered Persons are defined by the Rule to include:

- **Senior Management.** Senior management with responsibility over Covered Functions³
- **Supervisors.** Supervisors, managers or other persons responsible for approving or authorizing work, including work of other persons, in direct furtherance of Covered Functions
- **Other Authorized Persons.** Persons with the authority or discretion materially to commit a member’s capital in direct furtherance of Covered Functions or to commit a member to any material contract or agreement (written or oral) in direct furtherance of Covered Functions

The FINRA Response Letter clarified that the first prong of the Covered Person definition applies to senior management with *direct* responsibility over Covered Functions. Accordingly, senior management who sign off on Covered Functions, and who are responsible for ensuring that Covered Functions are executed in compliance with Federal securities laws and regulations

³ FINRA Rule 1230(b)(6)(B) defines Covered Functions as: (1) client on-boarding (customer account data and document maintenance); (2) collection maintenance, re-investment (i.e., sweeps) and disbursement of funds; (3) receipt and delivery of securities and funds, account transfers; (4) bank custody, depository and firm account management and reconciliation; (5) settlement, fail control, buy ins, segregation, possession and control; (6) trade confirmation and account statements; (7) margin; (8) stock loan/securities lending; (9) prime brokerage (services to other broker-dealers and financial institutions); (10) approval of pricing models used for valuations; (11) financial control, including general ledger and treasury; (12) contributing to the process of preparing and filing financial regulatory reports; (13) defining and approving 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; (14) defining and approving business security requirements and policies for information technology, including, but not limited to, systems and data, in connection with the Covered Functions; (15) defining and approving information entitlement policies in connection with the Covered Functions; and (16) posting entries to a member’s books and records in connection with the Covered Functions to ensure integrity and compliance with the Federal securities laws and regulations and FINRA rules.

and FINRA rules, will need to register as Operations Professionals. The FINRA Response Letter stated that the second prong of the Covered Person definition is intended to make clear that senior management of a broker-dealer may designate the next tier of management or other persons responsible for approving or authorizing work in direct furtherance of the Covered Functions, in accordance with reasonable business practices, although any Covered Person is responsible for ensuring that Covered Functions are performed correctly in accordance with industry rules, firm protocols, policies and procedures by virtue of their position.

Anticipated Impact

The Rule creates a function-based registration requirement; therefore, broker-dealers must examine the activities of their operations personnel to determine who will be required to register. Although the list of Covered Persons and Covered Functions is quite broad, FINRA stated that unregistered employees who engage solely in clerical or ministerial activities in connection with a Covered Function are not subject to the Rule. Persons whose activities are limited to performing a function ancillary to a Covered Function, or whose function is supportive or advisory to the performance of a Covered Function (such as internal audit, legal or compliance), are also not subject to the Rule—so long as they do not maintain primary responsibility for a Covered Function.⁴

The overall impact of the Rule is expected to be minimal, as the majority of Covered Functions are typically performed by a carrying and clearing broker-dealer pursuant to a clearing arrangement. In such cases, it may be possible for a small broker-dealer to rely on certain personnel, such as the Financial and Operations Principal and delegates, to liaise with the carrying and clearing firm regarding those Covered Functions, in which case only the Financial and Operations Principal and delegates may need to

⁴ FINRA indicated that the following categories of individuals would not be viewed as associated persons of a broker-dealer: employees of financial institutions providing distinct cash management services in connection with a brokerage account, and employees of providers of data elements to a broker-dealer as part of its execution of Covered Functions. Accordingly, such persons are not Covered Persons with respect to the broker-dealer.

register as Operations Professionals.⁵ Many persons who will be subject to the new Operations Professional registration category will qualify for the exception from the qualification examination, based on their existing registrations. FINRA will not assess a separate registration fee for persons relying on the exception from the qualification examination to register as Operations Professionals.

Qualification Examination Requirement and Exceptions

There will be a qualification examination—the Series 99—to register as an Operations Professional. The test will examine a person’s general knowledge of his or her regulatory obligations and comprehension of the broker-dealer business, as well as understanding of ethical concerns and Covered Functions. However, the Rule provides an exception from the examination requirement, for persons who currently hold certain eligible registrations or who have held one during the two years immediately prior to registering as an Operations Professional. The exception also applies to persons who do not hold an eligible registration, but prefer an alternative to taking the Operations Professional examination. Such persons will 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.⁶ The registered representative-level registration categories that enable persons to register as an Operations Professional without having to complete the qualification examination include: the Series 6, 7, 17, 37 and 38. The principal-level registration categories that enable persons to register as an Operations Professional without having to complete the qualification examination include: the Series 4, 9/10, 14, 16, 24, 26, 27, 28, 51 and 53. The exception applies to the Operations

⁵ A Covered Person would not be considered an associated person of both the introducing and clearing firms based solely on functions performed pursuant to a carrying agreement; therefore, dual registration as an Operations Professional is not expected in such cases.

⁶ The Rule provides that the FINRA staff may accept, as an alternative to the Operations Professional qualification examination requirement, any domestic or foreign qualification, if the staff determines this is consistent with the purposes of the Rule, the protection of investors, and the public interest.

Professional examination requirement only and not the Firm Element training.⁷

Implementation Period and Grace Period

Beginning on the effective date of the Rule, broker-dealers will have a 60-day window to identify and register Covered Persons as Operations Professionals via Form U4 (“Day-One Professionals”).⁸ Any person who is not subject to the registration requirements for Operations Professionals as of the effective date of the Rule (“non-Day-One Professionals”) will be required to register as an Operations Professional and, if applicable, pass the Operations Professional qualification examination (or an eligible qualification examination), prior to engaging in any activities that would require such registration. However, any non-Day-One Professional associated with a broker-dealer, who must pass the Operations Professional qualification examination (or an eligible qualification examination) to obtain registration, will have a 120-day grace period to pass such qualifying examination beginning on the date such person requests Operations Professional registration. During the 120-day period, such person may function as an Operations Professional.

Issues for Broker-Dealers and Affiliates Using Shared Services

For broker-dealers that share “back office” functions with investment advisers and other entities, a common arrangement among affiliates, determining whether an Operations Professional must register may be more complicated. Such affiliated entities should consider taking the following actions:

- ensure that “back office” functions are appropriately reviewed and that specific procedures are in place that assign accountability to specific

⁷ FINRA’s Firm Element training rule requires broker-dealers to “maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. At a minimum, each member shall at least annually evaluate and prioritize its training needs and develop a written training plan.” See NASD Rule 1120(b)(2)(A).

⁸ Day-One Professionals who are identified during the 60-day window, and must therefore pass the Operations Professional examination (or an eligible qualification examination) to qualify, will have 12 months to pass such qualifying examination beginning on the effective date of the Rule. During the 12-month period, such persons may function as Operations Professionals.

individuals. Certain Operations Professionals not employed by the broker-dealer may have responsibilities that require registration with FINRA;

- adopt a more formal separation of shared services, including separate work spaces, employees and supervisory procedures, which may be needed if the affiliates seek to limit the number of persons required to register with FINRA pursuant to the Rule; and
- in the absence of more formal separation of shared services in favor of registering new persons with FINRA, consider whether such new registrations will provide FINRA with expanded access to oversight of investment advisory and other non-broker-dealer business lines.

Conclusion

Despite the regulatory requirements imposed by Rule 1230(b)(6), the practical impact might turn out to be minimal. While the examination requirements might be burdensome and the Rule's reach to "back office" personnel, including those not directly employed by the broker-dealer, is broad, the variety of exceptions and the extended period in which to comply may mitigate the Rule's impact on most FINRA members.

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