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New FINRA Rule 1230(b)(6): Operations Professionals Must Register and Pass an Examination

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On June 16, 2011, the SEC approved new FINRA Rule 1230(b)(6). This Rule becomes effective October 17, 2011 and will impact every FINRA member broker-dealer, regardless of size or business lines. The Rule will require, for the first time, that certain "back office" operations personnel of FINRA members register with FINRA and pass a qualification examination. Senior management with direct responsibility for "back office" functions also must register and meet examination requirements.

As stated in FINRA's proposal for Rule 1230(b)(6), FINRA believes that operations professionals need registration and qualification requirements in order to make certain that customers are protected in all areas of a FINRA member's business, including the "back office." In addition, as also stated in the Rule proposal, in light of recent broker-dealer failures and scandals that implicated "back office" wrongdoing as much as that in "front offices," it is FINRA's position that the Rule will enhance protection of the marketplace and the public.

FINRA Regulatory Notice 11-33 provides that the qualification examination will cover both general securities and "back office" knowledge. In preparation for the October 17, 2011 effective date, FINRA members will have to determine which personnel need to be registered and devote resources to enable its operations personnel to prepare for and pass the examination. Moreover, because the Rule makes clear that FINRA considers "back office" functions and supervision important components of customer protection, FINRA members should anticipate increased regulatory scrutiny of these areas. The personnel and areas covered by the new Rule, and some considerations for FINRA members and their affiliates, are discussed more fully below.

3 Types of Operations Professionals Must Register

Rule 1230(b)(6) requires three types of personnel to pass an examination and register with FINRA as an "Operations Professional":

1. Senior Management. Senior management with direct responsibility over certain covered "back office" functions (the "Covered Functions") (as further discussed below);
2. Supervisors. Any person designated by senior management as a supervisor, manager, or other person "responsible for approving or authorizing work, including work of other persons in direct furtherance" of the Covered Functions; and
3. Other Personnel with Authority. Persons with "the authority or discretion materially to commit a member's capital" or "to commit a member to any material contract or agreement" in direct furtherance of the Covered Functions. The Rule provides that FINRA will defer to firms' "pre-established spending guidelines and risk management policies" to determine what is "material."

It is important to note that any person whose activities are limited to performing a function that is "ancillary," only supportive or advisory, or solely clerical or ministerial to a Covered Function will not be required to register as an Operations Professional. In general, this will mean that internal audit, legal, or compliance personnel who do not have primary responsibility for a Covered Function will not need to register.

Most Traditional "Back Office" Activities Are Covered Functions

The Rule describes 16 categories of Covered Functions that encompass most operations functions traditionally considered "back office":

- Client on-boarding (customer account data and document maintenance);
- Collection, maintenance, reinvestment (i.e., sweeps), and disbursement of funds;
- Receipt and delivery of securities and funds, account transfers;

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- Contributing to the process of preparing and filing financial regulatory reports;
- 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;
- 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;
- Defining and approving information entitlement policies in connection with the Covered Functions; and
- Posting entries to a FINRA 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.

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In general, personnel with supervisory and other authority over traditional "back office," operational and certain information technology functions will need to be registered.

Operations Professionals Must Pass the New Series 99 Examination or Qualify for an Exception

The Rule provides that any person who is required to register as an Operations Professional must pass the Operations Professional qualification examination before such registration may become effective. According to FINRA Regulatory Notice 11-33, the Operations Professional exam, which has been designated Series 99, will test a broad, basic understanding of the broker-dealer business and regulatory requirements. The exam will cover general professional conduct and ethical considerations for the securities industry, essential product and market knowledge for an Operations Professional, and broad-based knowledge of the Covered Functions. While FINRA will issue a separate Regulatory Notice relating to the exact content of the Series 99/Operations Professional exam, it can be anticipated that, as with other FINRA exams, with diligent studying, attention to detail, and/or review courses, most people will be able to pass the exam.

Persons who already hold certain FINRA registrations or have held such registrations in the preceding two years, however, will not need to pass the Operations Professional exam to qualify to register as an Operations Professional. These exceptions include, without limitation, General Securities Representative (Series 7), General Securities Principal (Series 24), Compliance Officer (Series 14), Supervisory Analyst (Series 16), and Financial and Operations Principal (Series 27).

Of particular note, Rule 1230(b)(6) does not include an exception "grandfathering" existing Operations Professionals, based upon their years or extent of experience.

Timing of Registration Will Vary

FINRA members will have until December 16, 2011, 60 days from the October 17, 2011 effective date, to identify existing personnel who will need to register as Operations Professionals and to indicate this on each such person's Form U4. These persons will then have until October 17, 2012, 12 months from the effective date, to pass the Operations Professional exam, unless an exception applies, during which time they may function as Operations Professionals.

Personnel who become required to register as Operations Professionals after the October 17, 2011 effective date (such as newly hired or promoted employees), must register as such before engaging in any activities that require registration. However, such personnel will have a 120-day grace period to pass the Operations Professional examination, unless an exception applies, during which time they may function as Operations Professionals.

What This Means for FINRA Member Broker-Dealers

To ensure compliance with Rule 1230(b)(6), FINRA member broker-dealers should:

1. Immediately begin evaluating which of their "back office" personnel and supervisors, including senior management, will need to register as Operations Professionals;
2. Review their organizational charts and reporting structure to determine which supervisory personnel have direct responsibility for the Covered Functions and consider whether to streamline supervision and responsibility to reduce the number of personnel who will need to register;
3. Designate sufficient resources to assist Operations Professionals in preparing for and passing the Series 99 examination;
4. Consider drafting written supervisory procedures that clearly describe "back office" procedures and assign specific personnel with supervisory responsibilities, because such areas currently may be covered only by informal operations procedures; and
5. Consider increasing supervisory, compliance, and internal audit review of "back office" functions and personnel to ensure all relevant regulatory rules and requirements are being followed. Increased regulatory scrutiny, in the form of FINRA inquiries and examinations, can be anticipated in light of the new Rule.

What This Means for Investment Advisers and Other Entities That Share Services with

Broker-Dealers

Registration of Operations Professionals may be particularly complicated for investment advisers and other entities that share "back office" and other services with FINRA member broker-dealers, a common arrangement among affiliates. In addition to the items above, such investment advisers or other entities should:

1. Review "back office" functions and personnel, including senior management, shared by the adviser or other entity and the broker-dealer to determine which personnel will need to register as Operations Professionals. It is possible that certain Operations Professionals not employed by the FINRA member but who have responsibilities to the broker-dealer may, in fact, need to register based on such personnel's responsibilities;
2. Consider a formal separation from the broker-dealer of "back office" functions and personnel, including separate work space, employees, and supervision, in order to limit which personnel will be required to register; and
3. Consider whether shared personnel becoming registered with FINRA will provide FINRA with the capability of reaching aspects of the investment advisory or other nonmember entities' business.

Conclusion

Implementing Rule 1230(b)(6), in the short term, is likely to be administratively time-consuming and potentially expensive, depending on the resources necessary for personnel to pass the Operations Professional exam. In the longer term, based on the customer protection rationale for the new Rule, increased regulatory oversight by FINRA of broker-dealer "back office" functions and supervision is expected.

Please contact any of the attorneys listed, or any other member of [Lowenstein Sandler's Investment Management Group](#), for further information on the matters discussed herein.

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