



Risk Management Update April 2011

NEW REQUIREMENTS FOR CERTAIN BROKER-DEALER OPERATIONS PERSONNEL ON THE HORIZON

In response to the growing complexity of the financial services industry on March 14, 2011 the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC”) a proposed rule change to adopt FINRA Rule 1230(b)(6) to create a new registration category for operational personnel. The new registration category, which would require a qualifying examination and continuing education requirements, is aimed to address potential regulatory gaps for individuals responsible for performing or overseeing a broker-dealer’s operational functions.

Historically, only broker-dealer personnel who provided advice or recommendations to clients, effected securities transactions, and/or held a supervisory position had to take a qualifying exam and fulfill certain continuing education requirements.

FINRA now has expanded this list. In the proposal, FINRA clarified that unregistered individuals who perform and oversee firm operations functions play an integral role in the firm’s business. Such individuals have a meaningful connection to client funds, accounts, and transactions, and consequently, it is important to have a licensing and educational program for them in place. This will help to further enhance investor protection mechanisms for broker-dealer firms and help bolster the integrity of the marketplace with the public.

Only personnel who are both “covered persons” and conduct activities or functions in one or more of the “covered functions” would be subject to the new Operations Professional registration category. A *covered person* is defined as a person who is directly responsible for overseeing an operation within those “covered functions” as performed in accordance with industry rules, firm protocols, policies and procedures. Such persons are charged with protecting the functional and control integrity of their designated covered functions within that firm.

For purposes of this rule proposal, a *covered function* is defined as an activity that involves:

- Client on-boarding (customer account data and document maintenance);
- Collection, maintenance, re-investment (i.e., sweeps) and disbursement of funds;
- Receipt and delivery of securities and funds, account transfers;
- Bank, custody, depository and firm account management and reconciliation;
- Settlement, fail control, buy ins, segregation, possession and control;
- Trade confirmation and account statements;
- Margin;
- Stock loan/securities lending;
- Prime brokerage (services to other broker-dealers and financial institutions);

- Approval of pricing models used for valuations;
- Financial control, including general ledger and treasury;
- 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 these covered functions, as well as 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 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.

Importantly, an individual, who performs a supportive function of the firm's operations or solely a clerical function, would not be subject to the registration.

Should broker-dealer personnel fall within any of these categories, the proposed rule would require them to register with the qualifying examination with FINRA as an Operations Professional. Typically, this would apply to:

- Senior management with responsibility over the covered functions;
- Supervisors, managers or other persons responsible for approving or authorizing work, including work of other persons, in direct furtherance of the covered functions; and
- Persons with the authority or discretion to materially commit a firm's capital in direct furtherance of the covered functions or to commit a firm to any material contract or agreement (written or oral) in direct furtherance of the covered functions.

FINRA foresees the proposed Operations Professional qualification examination to be a principles-based qualification examination with a regulatory focus to test a broad understanding of a broker-dealer's business, including basic understanding of the operational functions that support a broker-dealer's business and the regulations designed to achieve investor protection and market integrity. The continuing education components associated with the Operations Professional registration category would provide competency training specific to the covered functions, as applicable.

Broker-dealer firm personnel who hold or who have held the following registrations within two years immediately prior to registering as an Operations Professional would be exempt from passing the Operations Professional qualification examination:

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

Additionally, personnel 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. This would include broker-dealer firm personnel who hold or have held the following principal-level registrations, within two years immediately prior to registering as an Operations Professional:

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

To register, persons will be able to request the Operations Professional registration via Form U4 in the FINRA CRD system, and then either:

- pass the Operations Professional qualification examination;
- opt-in to such registration based on their holding, or having held within the past two years, an eligible registration; or
- register with FINRA in an eligible registration category and opt-in to the Operations Professional registration based on such eligible registration.

As stated in FINRA Notice to Members 05-48, FINRA would not expect each firm to have dual registration as an Operations Professional, but to designate at least one Operations Professional, who may be the FINOP and/or the Principal Operations Officer. All Operations Professionals would be subject to the same Continuing Education requirements of NASD Rule 1120 which would be reflected in the new Rule 1250.

For more information, please feel free to contact us at info@corecls.com.

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