New Broker Back-Office Personnel Registration, Exam and Continuing Education Requirements

GREGORY J. NOWAK | NOWAKG@PEPPERLAW.COM
MATTHEW R. SILVER | SILVERM@PEPPERLAW.COM

The Financial Industry Regulatory Authority (FINRA) has adopted, effective October 17, 2011, new Rule 1230(b)(6) (the new Rule) that establishes a registration category and qualification examination requirement for certain brokerage back-office operations personnel. FINRA also has imposed new continuing education requirements for such operations personnel.

While the new Rule will result in most brokers registering at least some of their back-office staff, once the rule is effective there will be a 12-month registration period for Day-One Professionals (as defined below) and a 120-day window for all new employees to take and pass the required Series 99 Operations Professional Qualifications Exam.

Back-office staff who maintain various other FINRA licenses (the Series 4, 6, 7, 9/10, 14, 16, 17, 24, 26, 27, 28, 37, 38, 51 or 53) will be exempt from the testing requirement, as will new staff who pass one of the above eligible qualification examinations. Staff who use an eligible qualification exam (such as the Series 7 instead of the Series 99) would be subject to the continuing education requirements of the eligible qualification exam (i.e., the Series 7) rather than that of the Series 99.

Pepper Point: Surprisingly, persons without one of the above-named exams but who do have a Series 79 (Investment Banking) license are not exempt from the new Series 99 exam requirements unless FINRA determines that acceptance of the Series 79 examination “is consistent with the purposes of [the New Rule], the protection of investors, and the public interest.”

WHO MUST REGISTER UNDER THE NEW REQUIREMENTS?

“Covered” persons subject to the registration, qualification and continuing educational requirements for an “Operations Professional” are:

1. Senior management with direct responsibility over “Covered Functions” as spelled out in the new Rule.

FINRA Rule 1230.06 provides that any person whose activities are limited to performing 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 (e.g., internal audit, legal or compliance personnel who review but do not have primary responsibility for any covered function), or who engages solely in clerical or ministerial activities in a covered function is not required to register as an Operations Professional. FINRA has also stated that a person who signs off on and/or supervises the activities or personnel involved in writing code to implement firm systems and business requirements is not performing a function that is ancillary to a covered function because their responsibility has a direct nexus to the execution of an activity covered by the new Rule at a supervisory level.

2. Supervisors, managers or other persons responsible for approving or authorizing work, including work of other persons, in direct furtherance of the Covered Functions.

FINRA has stated that it views covered persons engaging in one or more of the covered functions on behalf of the member to be associated persons of the member, irrespective of their employing entity, and the new Rule would require such persons to be registered with FINRA as an Operations Professional. However, FINRA also recognizes the distinction between shared services models and arrangements in which another financial institution provides distinct cash management services in connection with a brokerage account. In the latter situation, FINRA has stated that it would not view the financial institution’s employees to be associated persons of the member. Moreover, FINRA recognizes
that certain data elements may be purchased by a member as part of its execution of certain covered functions, and FINRA would not view employees of such providers of data elements to be associated persons of the member based solely on these activities.4

(3) Persons with the authority or discretion materially to commit a member's capital in direct furtherance of the covered functions or to commit a member to any material contract or agreement (written or oral) in direct furtherance of the Covered Functions.

Under FINRA Rule 1230.06 (Scope of Operations Professional Requirement), the determination as to what constitutes “materially” or “material” is based on a member firm’s pre-established spending guidelines and risk management policies. Generally, persons who do not have the authority or discretion to commit a member firm’s capital, or to commit a member firm to a contract or agreement, above such pre-established spending guidelines and risk management policies, are not subject to registration as an Operations Professional under this provision.

Pepper Point: Only persons who are covered persons and who conduct activities or functions in one or more of the covered functions are subject to the new Operations Professional registration category. Generally, covered persons would be those persons who are directly responsible for seeing that tasks within the covered functions are performed correctly in accordance with industry rules, firm protocols, policies and procedures. “Covered person” also includes persons who are charged with protecting the functional and control integrity of the covered functions for a member. Thus, only persons who are both “covered persons” (i.e., meet the depth of personnel criteria) and conduct activities or functions in one or more of the “covered functions” would be subject to the new Operations Professional registration category.

The Rule specifically excludes persons whose activities are limited to performing 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 (e.g., internal audit, legal or compliance personnel who review but do not have primary responsibility for any covered function), or who engages solely in clerical or ministerial activities in a covered function.

Timeline of Registration and Examination Requirements

Existing (as of October 17, 2011) personnel of a FINRA member whose job duties require them to register under the new Rule (Day-One Professionals) must request registration as an Operations Professional via Form U4 in CRD no later than December 16, 2011. Day-One Professionals must pass the Operations Professional examination (or an eligible qualification examination) by October 17, 2012. This 12-month transition period to pass a qualification examination only applies to Day-One Professionals.

Any person who is not subject to the registration requirements for Operations Professionals as of the effective date of the rule change (non-Day-One Professionals) would 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 who must pass the Operations Professional qualification examination (or an eligible qualification examination) to obtain registration will be granted a grace period of 120 days beginning on the date such person requests Operations Professional registration to pass such qualifying examination, during which time such person may function as an Operations Professional.

Exception to Qualification Examination Requirements

The new Rule includes an exception to the Operations Professional qualification examination requirement for persons who currently hold certain registrations3 (each an “eligible registration”) or have held one during the two years immediately prior to registering as an Operations Professional. FINRA believes the eligible registrations (and corresponding examinations) serve as a valid proxy for the Operations Professional examination requirement. The new Rule also provides that FINRA staff may accept as an alternative to the Operations Professional qualification examination requirement any domestic or foreign qualification if it determines that acceptance of such alternative qualification is consistent with the purposes of the Rule, the protection of investors, and the public interest.

Pepper Point: The examination 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 - i.e. take the Series 7 or any other qualifying exam and skip the Operations Professional examination.
The new Rule adds continuing education requirements for registered Operations Professionals and 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 proposed FINRA Rule 1250 (Continuing Education Requirements). The continuing education elements for this registration category would provide more specific learning materials appropriate for an Operations Professional, 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. 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.

Pepper Point: Individuals who avail themselves of the proposed exception to the Operations Professional qualification examination requirement with an eligible registration (such as a Series 7) 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 (Series 7) under the exception would be subject to the S101 continuing education program in lieu of the Operations Professional Regulatory Element training, and a person who registers by holding a General Securities Principal registration (Series 24) would be subject to the S201 continuing education program in lieu of the Operations Professional Regulatory Element training. However, Operations Professionals using a “waive in” license would still be subject to Firm Element training based on their activities at the firm (which would include the activities in the covered functions that mandate their registration as an Operations Professional).

Endnotes


2 FINRA believes that the use of the word “direct” (as inserted in FINRA’s Amendment No. 1 to the proposed rule change prior to the approval of the new Rule by the SEC) will better enable members to identify who must register as an Operations Professional and clarify that senior management with an indirect relationship to the covered functions are not subject to the proposed registration, qualification examination and continuing education requirements. FINRA states that the proposal’s aim is not to require registration for personnel with an indirect connection to the covered functions. However, FINRA members must ensure senior management that sign off on the covered functions and who are responsible for ensuring the covered functions are executed in compliance with the federal securities laws and regulations and FINRA rules must be properly registered.

3 “Covered Functions” are defined as:
   (i) client on-boarding (customer account data and document maintenance)
   (ii) collection, maintenance, re-investment (i.e., sweeps) and disbursement of funds
   (iii) receipt and delivery of securities and funds, account transfers
   (iv) bank, custody, depository and firm account management and reconciliation
   (v) settlement, fail control, buy-ins, segregation, possession and control
   (vi) trade confirmation and account statements
   (vii) margin
   (viii) stock loan/securities lending
   (ix) prime brokerage (services to other broker-dealers and financial institutions)
   (x) approval of pricing models used for valuations
   (xi) financial control, including general ledger and treasury
   (xii) contributing to the process of preparing and filing financial regulatory reports
   (xiii) 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
(xiv) 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
(xv) defining and approving information entitlement policies in connection with the covered functions, and
(xvi) 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.

4 FINRA notes that the Rule does not speak to the propriety of relying on one or more data elements provided by third parties.

5 “Eligible registrations” include registrations with FINRA as a General Securities Representative (Series 7), Investment Company Products/Variable Products Principal (Series 26), Financial and Operations Principal (Series 27), Investment Company Products/Variable Contracts Representative (Series 6), United Kingdom Securities Representative (Series 17) or Canada Securities Representative (Series 37 or 38), Registered Options Principal (Series 4), General Securities Sales Supervisor (Series 9/10), Compliance Officer (Series 14), Supervisory Analyst (Series 16), General Securities Principal (Series 24), Introducing Broker-Dealer Financial and Operations Principal (Series 28), Municipal Fund Securities Limited Principal (Series 51) or Municipal Securities Principal (Series 53), 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 is not revoked, suspended or otherwise deemed inactive.