



Financial Industry Regulatory Authority

Thomas M. Selman
Executive Vice President
Regulatory Policy

November 16, 2010

Jennifer B. McHugh
Senior Advisor to the Chairman
Office of Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Ms. McHugh:

It was a pleasure meeting with you to discuss issues related to the study required by the Dodd-Frank Act regarding broker-dealer and investment adviser standards of care. During the meeting, Commission staff inquired about the sufficiency of current qualification requirements for investment adviser personnel.

At that time, we offered to follow up with staff regarding our qualification examinations programs and our thoughts on how an investment adviser personnel qualification program might be developed and implemented. Accordingly, please find enclosed a memorandum that summarizes our thoughts on this issue. We have sent a similar letter and memorandum to Bob Plaze.

We would be happy to discuss our thoughts and the memorandum with you at your convenience. If you would like to discuss these matters further, please do not hesitate to contact me at 202-728-6977.

Sincerely,

A handwritten signature in black ink, appearing to read "Thomas M. Selman".

MEMORANDUM

TO: Derek Linden
Tom Selman

FROM: John Kalohn
Joe Savage

DATE: November 16, 2010

RE: Investment Adviser Qualification Examination Program

Background

As you are aware, FINRA staff recently met with Commission staff on separate occasions to offer our thoughts on the studies required by the Dodd-Frank Act regarding broker-dealer and investment adviser standards of care and the need for enhanced examination and enforcement resources for investment advisers. During both meetings, the Commission staff inquired about the sufficiency of current qualification requirements for investment adviser personnel.

At that time, we offered to follow up with the staff regarding our qualification examinations program and our thoughts on how an investment adviser personnel qualification examination program might be developed and implemented. This memorandum is intended to summarize our thoughts on this issue.

FINRA Experience in Qualification Examinations and Continuing Education Programs

For over 50 years, FINRA has helped ensure the integrity of the securities industry by providing qualification examinations and continuing education (CE) programs. FINRA has developed, maintained, and administered its own examinations, we have provided examination services to other organizations, and we have entered into partnerships to develop qualification examination programs that we own with other regulatory organizations (i.e., CBOE, MSRB, NASDAQ OMX, NYSE Amex, and NYSE Arca). Most recently, FINRA has provided a wide array of qualification examination and CE services to the mortgage industry to qualify mortgage loan originators.

In the financial services industry, FINRA develops and maintains over 30 FINRA and NYSE qualification examinations and delivers over 40 qualification examinations on behalf of itself, NYSE, NASAA, MSRB, and NFA. FINRA staff has extensive experience developing and maintaining the qualification examinations with industry-based content committees. This process has helped to ensure that the examinations are kept current with securities laws, industry rules and regulations.

FINRA staff also develops the content for three CE programs: the S201 Supervisors Program for registered principals and supervisors; the S106 for Series 6 Investment Company Products/Variable Contracts Representatives, and the S101 General Program for Series 7 and all other registrations. These programs are developed with assistance from industry-based content committees, SROs (e.g., CBOE and MSRB) and the CE Council, which is comprised of industry representatives. These programs are designed to keep registered persons up-to-date on current industry issues, new or changing rules and regulations, and industry best practices.

FINRA's extensive experience in delivering examinations and CE content for the securities industry has enabled the annual delivery of over 450,000 qualification examinations and CE sessions through its dual vendor delivery network using Pearson VUE and Prometric computer-based testing centers. FINRA's two-vendor network provides a wide footprint with access to over 500 test centers and locations in every state, U.S. territory and the District of Columbia.

In addition to the testing services for the securities industry, FINRA develops and maintains the National examination and over 50 Mortgage Loan Originator state licensure examinations for the mortgage industry allowing the Conference of State Bank Supervisors (CSBS) to launch its examination programs to the mortgage industry in a very short time. FINRA expects to deliver more than 300,000 mortgage examinations this year. The mortgage industry's education requirements consist of pre-licensure and CE courses developed and delivered by independent course providers approved by CSBS. FINRA provides a system for tracking all of the education requirements for the mortgage industry.

Investment Adviser Qualifications Program Structure

In creating a qualifications program for investment advisers (IAs), the Commission should consider a program that is tailored to the law, regulations, services and products offered by investment advisers. This structure would provide for the qualification and registration of investment adviser representatives (IARs) and supervisory personnel.¹

These persons should be required to complete an appropriate qualification examination and CE program to ensure that they are proficient in their field and in the rules and regulations that apply to them. While the structure would resemble FINRA's model for broker-dealers, there would be major differences in the content of the qualification examinations and CE programs to reflect the differences between broker-dealers and investment advisers.

¹ FINRA recognizes that many states currently require investment adviser personnel to pass the Uniform Investment Adviser Law (Series 65) Examination in order to register with such states as an investment adviser representative. FINRA does not take any position as to whether the Series 65 Examination should be augmented or replaced as a requirement for IAR registration. We also take no position on whether the receipt by an IAR of any designation offered by a private institution, such as the CFA or the CFP designation, should serve to exempt the IAR from a requirement to pass a qualifications examination.

Development and Maintenance of the Qualification Examination and CE Program Content

The Commission may wish to follow a program development model similar to the model that is used for broker-dealer qualification examinations and CE programs. This model employs testing industry standards for the creation of entry and principal-level qualification examinations. The continuing education programs that are used with broker-dealers employ state-of-the-art instructional design standards and incorporate best practices from adult learning theories to create content and assessment components.

Representatives from the industry serve on “content committees,” which help us to develop and maintain these programs. The inclusion of practitioners and regulators from the industry is invaluable in providing insights into current practices and how regulation affects the job of both the supervisor and the IAR. These insights facilitate the development of content that is current with industry practices and applicable law.

Development of Qualification Examinations

In developing qualification examinations for supervisors and IARs, it will be critical to document the knowledge and skills that are requisite for a person to demonstrate proficiency in the subjects relevant to a particular registration category. Conducting a job analysis study affords the opportunity to collect and analyze data to validate what content should be included in each qualification examination. The Commission may wish to select a job analysis study model that uses a variety of data collection methods to gather information from industry and regulatory participants to identify the essential knowledge and skills and the importance of each. This information will then be used to create the content outline for each examination and also specify the weighting (i.e., the number of test questions) for each section of the content outlines.

These examinations should test an applicant’s knowledge of both business-related and regulatory content. While we do not attempt to create an exhaustive list of all content that such an examination would cover, it may be useful to provide some examples of content that might be included in a supervisory or IAR examination. Ultimately, an examination’s content should be determined through the processes of developing and maintaining qualification examinations described above.

The SEC may wish to develop specialized examinations for particular segments of the investment advisory industry. For example, the qualification examination for an institutional account portfolio manager may differ significantly from an examination for a retail advisory representative.

Some examples of business-related content include:

- Basic economic concepts
- Financial statements and reports

- Types and characteristics of risks
- Types and characteristics of securities and investments
- Types of clients and client needs
- Portfolio management techniques, styles and strategies
- Trading strategies and issues
- Performance measures

Some examples of regulatory content include:

- Supervisory requirements
- Compliance policies, procedures and audits
- Custody requirements
- Client account statements
- Registration requirements
- Rules and regulatory interpretations governing advertising and communications
- Recordkeeping requirements
- Standard of care/fiduciary duty
- Disclosure of conflicts, risks and fees
- Privacy laws
- Trade monitoring and best execution
- Insider, affiliate and personal trading restrictions
- Principal trading and agency cross transactions
- Anti-fraud standards
- Referral fees and use of solicitors
- Contractual requirements
- Restrictions on political contributions
- Anti-money laundering procedures
- Gifts and gratuities
- Prohibited activities

Development of Continuing Education Programs

The Commission may wish to consider that investment advisers and their supervisors be required to complete continuing education in a manner parallel to the securities industry. Given that a high percent of the investment advisers are dually registered as General Securities representatives, two CE programs might be implemented for IARs: one for IARs who are only associated with a registered investment adviser, and another for IARs who are associated with both a broker-dealer and an investment adviser. The latter program would streamline the CE process for dually registered individuals by eliminating overlapping material from the separate broker-dealer and investment adviser CE programs.

The development of content for the continuing education programs should be driven by the results of the job analysis study, current industry trends and regulatory changes. This CE

program should cover many of the same topics discussed above regarding qualification examinations. The exact content outline would be finalized based on a thorough analysis of data with input from representative individuals from industry and regulators in the investment adviser arena, as discussed above.

Implementation

As discussed above, FINRA has significant experience developing and implementing qualification examinations and CE programs in a number of fields. FINRA believes that, using its existing model, and working closely with Commission staff, it could quickly and efficiently develop and implement qualification examinations appropriate for individuals serving in the advisory industry. We look forward to working with the Commission staff to discuss these issues.