

## VIA ELECTRONIC MAIL

April 8, 2011

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549- 1090

RE: SR-FINRA-2011-013 - Qualification Examination and Continuing Education  
Requirements for Certain Operations Personnel

Dear Ms. Murphy:

On March 4, 2011, the Financial Industry Regulatory Authority, Inc. (FINRA) filed SR-FINRA-2011-013<sup>1</sup> (Proposed Rule) with the Securities and Exchange Commission (SEC). The Proposed Rule sets forth FINRA's proposal to adopt FINRA Rule 1230(b)(6) which will establish a registration category and qualification examination requirement for certain operations personnel. The Proposed Rule change also would adopt continuing education requirements for such operations personnel and change NASD Rule 1120 (Continuing Education Requirements) to FINRA Rule 1250 (Continuing Education Requirements) in the consolidated FINRA rulebook.

The Financial Services Institute (FSI)<sup>2</sup> welcomes this opportunity to comment on the Proposed Rule. As indicated in our comment letter<sup>3</sup> on FINRA Regulatory Notice 10-25<sup>4</sup>, we support the intent of the Proposed Rule which seeks to enhance investor protection by providing additional training and education to individuals who supervise broker-dealer operations. We applaud and compliment FINRA on addressing many of the concerns we raised in our earlier comment letter. However, it is our opinion that the objectives laid out in the Proposed Rule can be achieved with a less expansive and less expensive approach. Specifically, we urge the SEC to drop the testing component of the Proposed Rule. In addition, we ask the SEC to narrow the breadth of the covered functions through well-crafted definitions of the terms. Finally, we ask that the Proposed Rule more specifically address functions shared by introducing broker-dealers and their clearing firms. These concerns are addressed in more detail below.

### Background on FSI Members

The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning

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<sup>1</sup> SR-FINRA-2011-013, available at <http://sec.gov/rules/sro/finra/2011/34-64080.pdf>,  
<http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p123266.pdf>

<sup>2</sup> The Financial Services Institute is an advocacy organization for the financial services industry – the only one of its kind – FSI is the voice of independent broker-dealers and independent financial advisors in Washington, D.C. Established in January 2004, FSI's mission is to create a healthier regulatory environment for their members through aggressive and effective advocacy, education and public awareness. FSI represents more than 125 independent broker-dealers and more than 16,000 independent financial advisors, reaching more than 15 million households. FSI is headquartered in Atlanta, GA with an office in Washington, D.C.

<sup>3</sup> FSI Comment Letter in response to Regulatory Notice 10-25, July 30, 2010, available at  
<http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticerecommendations/p121877.pdf>

<sup>4</sup> Regulatory Notice 10-25, Registration and Qualification Requirements for Certain Operations Personnel, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p121533.pdf>.

services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 180,000 financial advisors – or approximately 61.7% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.<sup>5</sup> These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.<sup>6</sup> Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

#### Comments on the Proposed Rule

As stated above, FSI welcomes this opportunity to comment on the Proposed Rule. We support the intent of the Proposed Rule because we believe investor protection will be enhanced by providing additional training and education to individuals who supervise broker-dealer operations. However, it is our opinion that the objectives of the Proposed Rule can be achieved with a less expansive and less expensive approach. Our specific concerns are addressed in more detail below.

- **Testing Component** – Regulatory Notice 10-25 indicates that the examination contemplated for Operations Professionals is not intended to be a competency exam.<sup>7</sup> The Notice provides that the examination “would test for general securities industry

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<sup>5</sup> Cerulli Associates at <http://www.cerulli.com/>.

<sup>6</sup> These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisors.

<sup>7</sup> Regulatory Notice 10-25, Registration and Qualification Requirements for Certain Operations Personnel, at 5.

knowledge with a regulatory focus to alert such persons that they are functioning in a heavily regulated industry.”<sup>8</sup> More specifically, it indicates that, “FINRA proposes the development of a single principles-based qualification examination with a regulatory focus to test for a broad understanding of a broker-dealer’s business at a basic level; a basic understanding of the operations functions that support a broker dealer’s business; and the regulations designed to achieve investor protection and market integrity that drive the operations processes and procedures conducted at a broker-dealer.”<sup>9</sup>

In our comment letter in response to Regulatory Notice 10-25, we indicated that we believe that FINRA can achieve the end result of ensuring that individuals who supervise, manage, and have discretion to commit the capital of firms understand that they are functioning in a heavily regulated industry simply by: 1) addressing supervision of the Covered Functions<sup>10</sup> in Written Supervisory Procedures (WSPs); and 2) through mandatory firm element training.

In response to our comment on this issue, FINRA states the following in the Proposed Rule filing:

“FINRA believes the qualification examination requirement is appropriate as proposed. The proposed examination is being tailored to test for basic securities industry knowledge and ethics. Although the examination will not test for proficiency with respect to the specific covered functions, FINRA believes there is value in an examination that tests for general knowledge about the securities industry. The proposed examination will be appropriately tailored to individuals subject to the proposed registration requirements. It is crucial for covered persons to understand their professional responsibilities, including key regulatory and control themes, as well as the importance of identifying and escalating red flags that may harm a firm, its customers, the integrity of the marketplace, or the public.

Additionally, FINRA believes a representative-level examination is appropriate for Operations Professionals because the proposed registration category is based on functions performed by operations personnel and is not limited to supervisory or managerial staff (e.g., persons who fall within proposed FINRA Rule 1230(b)(6)(A)(ii) and (iii)).”

We disagree with FINRA’s assessment and believe that well designed WSPs and training can ensure “general securities industry knowledge with a regulatory focus to alert such persons that they are functioning in a heavily regulated industry.” We are of the opinion that a qualifying examination simply tests the test takers’ ability to cram data for purposes of passing a standardized examination. Meanwhile, broker-dealers are already motivated to hire experienced and knowledgeable operations personnel to facilitate quality service and avoid regulatory entanglement. As a result, we do not believe that a formal examination is necessary to achieve FINRA’s stated objective.

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> A Covered Function is defined in FINRA Proposed Rule 1230(b)(6)(B), *supra* note 1

Instead, we urge FINRA to require firms to emphasize the important role operations personnel play through specific discussion of the Covered Functions in their WSPs and other firm procedures. In addition, firms should be required to adopt a course of instruction on the regulatory requirements and best practices related to the Covered Functions in their annual training. This approach would allow firms to personalize the training to the specific obligations of their business model. Given the unnecessary nature of the examination requirement in the Proposed Rule, we urge the SEC to remove subsection (C) from Proposed FINRA Rule 1230(b)(6).

- **Covered Functions** – In our comment letter in response to Regulatory Notice 10-25, we raised concerns about the Covered Functions related to individuals that deal with information technology (IT). In our comment letter, we asserted that this section of the Proposed Rule<sup>11</sup> was unclear and poorly defined. We indicated that we were uncertain of its application to individuals who work a firm’s IT department.

In response to our comment on this topic, in the Proposed Rule filed with the SEC, FINRA provides as follows:

“FINRA has made minor changes to the original proposal with respect to Rule 1230(b)(6)(B)(vii). The proposed rule change renumbers this provision as proposed FINRA Rule 1230(b)(6)(B)(xiv) and includes as a covered function, “[d]efining and approving business security requirements and policies for information technology, including, but not limited to, systems and data, in connection with the covered functions.” As noted above, FINRA believes that covered persons engaged in defining and approving business security requirements and policies for information technology should be registered as Operations Professionals.”

While we appreciate FINRA’s clarification that this Covered Function is targeted at individuals who define **and** approve business security requirements, we still believe that there is ambiguity surrounding this covered function. As defined, we believe this Covered Function could sweep in virtually all individuals who work in a firm’s IT department. Accordingly, we urge the SEC to require FINRA to better define the scope and application of this subsection of the Proposed Rule.

- **Shared Functions** – In our earlier comment letter, we raised concerns involving functions shared by an introducing broker-dealer and a clearing firm. We indicated that most independent broker-dealers operate as fully disclosed introducing broker-dealer firms. These firms often share responsibility for operational business functions with their clearing firm(s). Introducing broker-dealers and their respective clearing firms are required to enter in to a Clearing Agreement pursuant to NASD Rule 3230.<sup>12</sup> The Clearing Agreement sets out minimum obligations and responsibilities between the two parties. We argued that the Proposed Rule as set out in Regulatory Notice 10-25 did not

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<sup>11</sup> In Regulatory Notice 10-25, Proposed FINRA Rule 1230(b)(6)(B)(vii) was defined as the activity of “defining and approving business security requirements and policies for information technology (including, but not limited to, systems and data).

<sup>12</sup> NASD Conduct Rule 3230 – Clearing Agreements, available at [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=4428&element\\_id=3750&highlight=clearing+firm#r4428](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4428&element_id=3750&highlight=clearing+firm#r4428)

provide clarity as to whether an individual at the introducing broker-dealer or an individual at the clearing firm would be required to take the operations examination for shared functions.

In response to our comment on shared functions, the Proposed Rule filed with the SEC states as follows:

“... FINRA believes anyone who meets the criteria of a covered person and engages in one or more of the covered functions on behalf of a member must register as an Operations Professional, regardless of whether such person works internally at a member, an affiliate or third-party service provider. Also as previously noted, the proposed rule change does not alter the definition of an “associated person” but rather imposes registration, qualification examination and continuing education requirements on persons who meet the depth of personnel criteria and engage in one or more of the covered functions on behalf of a member. The proposed registration category is function-based so persons are not shielded from the requirements based on their job title or employment by an entity other than a member. Additionally, FINRA notes that the proposed rule change would apply to all members regardless of firm size. FINRA reminds members that the depth of personnel included as covered persons generally is focused on positions with higher-level responsibilities, so entry level staff will likely not be required to register.

With respect to clearing arrangements and consistent with Notice to Members 05-48, 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 approved under FINRA Rule 4311 (Carrying Agreements), so FINRA would not expect dual registration as an Operations Professional in such cases. However, as noted above, FINRA expects each member will designate at least one Operations Professional, who often may be the Financial and Operations Principal and/or the Principal Operations Officer.”

While we understand FINRA’s desire to err on the side of caution and require the registration of all individuals who may work in a Covered Function to register and test, we do not believe this approach is the most prudent. The need for flexibility in the system is essential. Taking a “one size fits all” approach will result in unnecessary testing and examination.

Rather than requiring individuals at both the introducing broker-dealers and clearing firms to register and test under the Proposed Rule, we suggest FINRA amend NASD Rule 3230 (n/k/a FINRA Rule 4311) to require that parties to a Clearing Agreement clearly designate who is responsible for any shared functions in the Agreement. This will reduce the economic and resource burden of requiring all individuals who meet the criteria of a Covered Function and who engage in one or more of the covered functions to register and test under the Proposed Rule.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to ensure operations professionals have the requisite knowledge and understanding of the industry and understand their important role in it.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8488.

Respectfully submitted,

Sincerely,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" followed by "Bellaire".

David T. Bellaire, Esq.  
General Counsel and Director of Government Affairs