

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64080; File No. SR-FINRA-2011-013)

March 14, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Establish a Registration Category, Qualification Examination and Continuing Education Requirements for Certain Operations Personnel, and Adopt FINRA Rule 1250 (Continuing Education Requirements) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 4, 2011, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt FINRA Rule 1230(b)(6) to 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 adopt NASD Rule 1120 (Continuing Education Requirements) as FINRA Rule 1250 (Continuing Education Requirements) in the consolidated FINRA rulebook with minor changes.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background

Given the growing complexity of the financial services industry and the importance of services provided by personnel in operations departments, FINRA is concerned about the potential for regulatory gaps in the area of registration and education requirements for individuals performing and overseeing member operations functions. Historically, federal and state law and self-regulatory organization ("SRO") rules, including NASD Rules 1021 and 1031, have required that individuals engaged in or supervising the securities or investment banking business of a member firm be qualified and registered persons. These requirements generally have applied to, among others, individuals with customer contact providing advice (sales persons and investment bankers) or effecting securities transactions (traders) and their supervisors. However,

unregistered individuals who perform and oversee member operations functions also play an integral role in the business of the firm, and their activities often have a meaningful connection to client funds, accounts and transactions. FINRA believes registration and education requirements for certain operations personnel are needed to help ensure that investor protection mechanisms are in place in all areas of a member's business that could harm the member, a customer, the integrity of the marketplace, or the public.

Proposal

As described in detail below, FINRA is proposing to expand its registration provisions to require registration of certain individuals ("covered persons") who are engaged in, responsible for or supervising certain member operations functions ("covered functions") to enhance the regulatory structure surrounding these areas. The proposed rule change would amend proposed FINRA Rule 1230 (Registration Categories) to adopt a new representative registration category and qualification examination for such individuals ("Operations Professionals")³ and would expand FINRA's continuing education requirements to require that Operations Professionals be subject to Regulatory Element and Firm Element training.

Generally, covered persons would be those persons who are directly responsible for overseeing that tasks within the covered functions are performed correctly in accordance with industry rules, firm protocols, policies and procedures, and who are charged with protecting the functional and control integrity of the covered functions for a

³ See Regulatory Notice 09-70 (December 2009) (FINRA Requests Comment on Proposed Consolidated FINRA Rules Governing Registration and Qualification Requirements). The proposed amendments discussed in this Notice would be included in proposed FINRA Rule 1230 (Registration Categories).

member. Only persons who are both “covered persons” (i.e., meet the depth of personnel criteria as discussed in Section A. below) and conduct activities or functions in one or more of the “covered functions” (discussed in Section B. below) would be subject to the new Operations Professional registration category.

A. Covered Persons for Inclusion in the New Registration Category

The proposed rule change would require the following covered persons to register with FINRA as an Operations Professional:

- (1) Senior management with responsibility over the covered functions;
- (2) Supervisors, managers or other persons responsible for approving or authorizing work, including work of other persons, in direct furtherance of the covered functions; and
- (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.

Persons who perform a covered function, but whose responsibilities are below these specified levels, would not be required to register as Operations Professionals. Members must determine, based on a person’s activities and responsibilities, whether such person would be considered a covered person and subject to the proposed requirements for Operations Professionals. A person’s job title may not be clearly indicative of his or her obligation to register as an Operations Professional.

For the purpose of the proposed third category of covered persons, any person who has the authority or discretion materially to commit firm capital in direct furtherance

of the covered functions or commit a firm to a material contract or agreement in direct furtherance of the covered functions would be required to register as an Operations Professional. As proposed in supplementary material .06 (Scope of Operations Professional Requirement), the determination as to what constitutes “materially” or “material” would be based on a member’s pre-established spending guidelines and risk management policies. Generally, persons who do not have the authority or discretion to commit a member’s capital, or to commit a member to a contract or agreement, above such pre-established spending guidelines and risk management policies would not be subject to registration as an Operations Professional under this provision.

Additionally, proposed supplementary material .06 would provide 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, or who engages solely in clerical or ministerial activities in a covered function would not be required to register as an Operations Professional pursuant to paragraph (b)(6)(A) of the proposed rule. For example, internal audit, legal or compliance personnel who review but do not have primary responsibility for any covered function would not be required to register as an Operations Professional.

Consistent with FINRA guidance, persons subject to the new Operations Professional registration category would be considered associated persons of a member irrespective of their employing entity, and would be subject to all FINRA rules applicable to associated persons and/or registered persons.⁴ Moreover, any person who meets the

⁴ See Notice to Members 05-48 (July 2005) (Members’ Responsibilities When Outsourcing Activities to Third-Party Service Providers). The Notice reminds members that “in the absence of specific NASD [or FINRA] rules, MSRB rules,

depth of personnel criteria described above in Section A. and is engaged in one or more covered functions would be required to register as an Operations Professional. The proposed rule change does not alter the status of covered persons as associated persons of a member insofar as they are performing regulated broker-dealer functions on behalf of the member. Rather, the proposed rule change explicitly imposes registration, qualification examination and continuing education requirements on such persons.

B. Covered Functions for Inclusion in the New Registration Category

Any person who meets the threshold in one of the three categories of covered persons identified above in Section A. who conducts activities or functions for a member in one or more of the following covered functions would be required to register as an Operations Professional:

- (1) Client on-boarding (customer account data and document maintenance);
- (2) Collection, maintenance, re-investment (i.e., sweeps) and disbursement of funds;
- (3) Receipt and delivery of securities and funds, account transfers;
- (4) Bank, custody, depository and firm account management and reconciliation;
- (5) Settlement, fail control, buy ins, segregation, possession and control;
- (6) Trade confirmation and account statements;
- (7) Margin;

or federal securities laws or regulations that contemplate an arrangement between members and other registered broker-dealers with respect to such activities or functions (e.g., clearing agreements executed pursuant to NASD Rule 3230), any third-party service providers conducting activities or functions that require registration and qualification under NASD [or FINRA] rules will generally be considered associated persons of the member and be required to have all necessary registrations and qualifications.”

- (8) Stock loan/securities lending;
- (9) Prime brokerage (services to other broker-dealers and financial institutions);
- (10) Approval of pricing models used for valuations;
- (11) Financial control, including general ledger and treasury;
- (12) Contributing to the process of preparing and filing financial regulatory reports;
- (13) 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;
- (14) 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;
- (15) Defining and approving information entitlement policies in connection with the covered functions; and
- (16) 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.

The proposed rule change would include persons engaged in or supervising stock loan/securities lending activities that meet the depth of personnel as a covered person in Section A. above. FINRA also is proposing separate registration categories for a “Securities Lending Representative” and a “Securities Lending Supervisor.”⁵

⁵ In Regulatory Notice 09-70, FINRA generally proposes to adopt the NYSE registration requirements for Securities Lending Representatives and Securities Lending Supervisors, requiring an associated person who has discretion to commit a member to any contract or agreement (written or oral) involving securities lending or borrowing activities with any other person, and the direct

C. Operations Professional Qualification Examination

The proposed rule change would establish a new qualification examination for Operations Professionals that would provide reasonable assurance that such individuals 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 member, a customer, the integrity of the marketplace, or the public.⁶ So that applicants understand that they are functioning in a heavily regulated industry, the proposed Operations Professional qualification examination would test applicants on general securities industry knowledge and its associated regulations and rules. Subject to the proposed exception in Section D. below, any person required to register as an Operations Professional would be required to pass the Operations Professional qualification examination before such registration may become effective.

In general, given the diversity of functions performed by covered persons, the proposed Operations Professional qualification examination would be a principles-based qualification examination with a regulatory focus to test for a broad understanding of a

supervisor of the associated person to register as a Securities Lending Representative and Securities Lending Supervisor, respectively. These individuals would be required to register as such for tracking and oversight purposes, regardless of whether they are registered in other categories. However, solely for purposes of registering as a Securities Lending Representative or Securities Lending Supervisor, an individual will not be subject to a qualification examination at this time.

⁶ Any individual whose activities go beyond those proposed for the Operations Professional registration category would be required to separately qualify and register in the appropriate category or categories of registration attendant to such activities.

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. As further detailed in Section E. below, the continuing education components associated with the Operations Professional registration category would provide competency training specific to the covered functions, as applicable.

The breadth and depth of coverage of the qualification examination would be determined through the use of testing industry standards used to develop examinations, and would include input and advice from covered persons active in the securities industry. The following are the proposed key content themes of the new Operations Professional qualification examination:

- Professional Conduct and Ethical Considerations: This section of the examination would assess a candidate's core knowledge addressed on other FINRA examinations that are appropriate for an Operations Professional. The questions would assess knowledge of what are considered serious violations of securities industry rules. This section would include ethics-based questions that address issues such as data integrity, escalation of regulatory red flags and separation of duties.
- Essential Product and Market Knowledge for an Operations Professional: This section of the examination would assess a candidate's basic product and market knowledge, including definitions and characteristics of major product categories (i.e., equities, debt, packaged securities, options and markets). An Operations Professional

would not be expected to know the same level of detail about the products and markets as a product specialist or a representative selling products to customers.

- Knowledge Associated with Operations Activities: This section of the examination would assess a candidate's broad-based knowledge regarding the covered functions outlined above that support a broker-dealer's business and the underlying rules that drive the processes associated with these activities (i.e., customer account set-up and transfers, recordkeeping requirements, rules associated with the protection of customer assets and transaction processing, uniform practices associated with making good delivery of securities, making payments for securities and meeting settlement requirements, and credit and margin rules). This section of the examination also would include ethics-based questions in the context of operations activities.

D. Exception to Operations Professional Examination Requirement

The proposed rule change would include an exception to the Operations Professional qualification examination requirement for persons who currently hold certain registrations (each an "eligible registration") or have held one during the two years immediately prior to registering as an Operations Professional. The proposed 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.

A person who wishes to obtain Operations Professional registration under the proposed exception would not be automatically waived-in, but would have to opt-in by

requesting Operations Professional registration via Form U4 (the Uniform Application for Securities Industry Registration or Transfer) in the Central Registration Depository (“CRD[®]”).⁷ If there are no other deficiencies (e.g., fingerprints), the Operations Professional registration would be approved automatically at the time such request is made. Information regarding the proposed implementation period is discussed in detail in Section F. below. FINRA would not assess a separate registration fee for persons relying on the proposed exception to register as Operations Professionals.

FINRA conducted a review of the content outlines for each qualification examination it recognizes and identified examinations with broad content coverage that would be eligible for an exception to the Operations Professional examination requirement. Accordingly, persons who hold the following representative-level registration categories, or who have held such registration categories within the two years immediately prior to registering as an Operations Professional, would be qualified to register as an Operations Professional without passing the Operations Professional qualification examination:

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

Additionally, persons who hold (or have held) certain principal-level registration categories would be qualified to register as an Operations Professional without passing

⁷ A person who qualifies for the proposed exception based on their having held an eligible registration within the two years immediately prior to registering as an Operations Professional would be required to first re-activate such eligible registration prior to requesting Operations Professional registration.

the Operations Professional examination. Most principal-level qualification examinations have a prerequisite examination requirement that is satisfied with one of the representative qualification examinations listed above; however, FINRA also proposes to include principal-level qualification examinations that do not have a prerequisite, or have a prerequisite that can be met with a qualification examination not on the above list (e.g., Series 62), because it is likely such principals are familiar with the content to be covered in the Operations Professional qualification examination as a result of the requirements of their positions. Specifically, persons who hold the following principal-level registration categories, or who have held such registration categories within the two years immediately prior to registering as an Operations Professional, would be qualified to register as an Operations Professional without passing the Operations Professional qualification examination:

- 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)
- Investment Company Products/Variable Products Principal (Series 26)
- Financial and Operations Principal (Series 27)
- Introducing Broker-Dealer Financial and Operations Principal (Series 28)
- Municipal Fund Securities Limited Principal (Series 51)
- Municipal Securities Principal (Series 53)

The proposed exception would not apply to persons whose eligible registrations are revoked pursuant to FINRA Rules 8310 (Sanctions for Violation of the Rules) or 8320 (Payment of Fines, Other Monetary Sanctions, or Costs; Summary Action for Failure to Pay), suspended or otherwise deemed inactive.⁸

FINRA notes that covered persons are generally acting in a supervisory position, so many persons will already hold one of the eligible registrations that would qualify for the exception to the Operations Professional examination requirement. As noted in Section A. above, entry-level operations personnel would not typically be subject to the proposed requirements for Operations Professionals.

E. Continuing Education Requirements for Operations Professionals

The proposed rule change 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).⁹ 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.

⁸ If a person's registration in an eligible registration category was revoked within the prior two years, but such person re-qualifies and re-registers in such eligible registration category, he or she may rely on this eligible registration to qualify for the exception to the Operations Professional qualification examination requirement. Further, a suspended registration may not be relied upon as an eligible registration during the suspension period. Similarly, a registration deemed inactive for any reason (e.g., failure to complete continuing education requirements) may not be relied upon as an eligible registration during such inactive period. See also FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar).

⁹ See Section G. for further discussion of the adoption of NASD Rule 1120 (Continuing Education Requirements) as FINRA Rule 1250.

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, as described in Section C. above. The breadth and depth of coverage of the modules would be determined through the use of existing industry standards currently used to develop continuing education content and would include input and advice from operations professionals active in the securities industry. 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.

Individuals who avail themselves of the proposed exception to the Operations Professional qualification examination requirement with an eligible registration described above 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.

Operations Professionals also would be subject to Firm Element training. To implement this change, as further discussed in Section G. below, the proposed rule change would include Operations Professionals in the definition of “covered registered persons” in proposed FINRA Rule 1250, and would require that firms deliver Firm Element training to Operations Professionals subject to the new registration and qualification requirements.¹⁰

F. Implementation of the Proposed Rule Change

As noted above, any person who meets the depth of personnel criteria described in Section A. and is engaged in one or more covered functions described in Section B. would be required to register with FINRA as an Operations Professional. Such persons would be required to register by doing one of the following, as applicable: (1) requesting Operations Professional registration via Form U4 in CRD and passing the Operations Professional qualification examination; (2) requesting Operations Professional registration via Form U4 in CRD and opting in to such registration based on their holding, or having held within the past two years, an eligible registration;¹¹ or (3)

¹⁰ NASD Rule 1120(b) (Continuing Education Requirements) is currently limited to registered persons who have direct contact with customers in the conduct of the firm’s securities sales, trading and investment banking activities, any person registered as a research analyst pursuant to NASD Rule 1050, and to the immediate supervisors of such persons. The proposed amendments are reflected in the new FINRA rule governing continuing education, FINRA Rule 1250, which is being proposed as part of this rule change. See Section G. below.

¹¹ Persons with an active eligible registration who request Operations Professional registration will be automatically granted Operations Professional registration once they submit such request via Form U4 in CRD, regardless of when such

requesting Operations Professional registration via Form U4 in CRD, registering with FINRA in an eligible registration category and opting in to Operations Professional registration based on such eligible registration.¹²

Members must identify persons required to register as an Operations Professional as of the effective date of the proposed rule change (“Day-One Professionals”) (i.e., persons who meet the depth of personnel criteria and are engaged in one or more covered functions as of the effective date of the proposed rule change). FINRA is proposing a 60-day identification period beginning on the effective date of the proposed rule change during which Day-One Professionals must request registration as an Operations Professional via Form U4 in CRD. During this 60-day period, a Day-One Professional may function in the capacity of an Operations Professional. Day-One Professionals who are identified during the 60-day period and must pass the Operations Professional examination (or an eligible qualification examination) to qualify (i.e., persons who do not hold, and have not within the past two years held, an eligible registration) would be granted 12 months beginning on the effective date of the proposed rule change to pass

persons apply for Operations Professional registration (provided there are no existing deficiencies). See also supra note 7.

¹² If a person elects to register with FINRA as an Operations Professional by newly qualifying in an eligible registration (i.e., does not have an active eligible registration when he or she requests Operations Professional registration via Form U4 in CRD), such person must contact FINRA upon passing the alternative examination to request that the eligible registration be applied to the request for Operations Professional registration. This would include, for example, a person who requests both the Operations Professional and General Securities Representative registrations via Form U4 in CRD and passes the Series 7 examination. Such person would be required to contact FINRA to alert FINRA staff that the General Securities Representative registration will be used as an eligible registration to qualify as an Operations Professional.

such qualifying examination, during which time such persons may function as an Operations Professional.¹³ To be eligible to function as an Operations Professional for the 12-month transition period, Day-One Professionals subject to an examination requirement must request Operations Professional registration via Form U4 in CRD during the 60-day identification period and pass the Operations Professional examination (or an eligible qualification examination) before the expiration of 12 months from the effective date of the proposed rule change.¹⁴ If a Day-One Professional does not pass an acceptable examination by the expiration of the 12-month transition period, such person must cease functioning as an Operations Professional.

The 12-month transition period to pass a qualification examination would only apply to Day-One Professionals. Any person who is not subject to the registration requirements for Operations Professionals as of the effective date of the proposed rule change (i.e., a person who does not meet the depth of personnel criteria and/or is not engaged in one or more covered functions as of the effective date, or persons hired after

¹³ When a person requests Operations Professional registration via Form U4 in CRD during the 60-day identification period, an examination window for the Operations Professional qualification examination will open in CRD that expires 12 months from the effective date of the proposed rule change. After the 60-day identification period, the examination window for the Operations Professional qualification examination will open for the standard 120 days.

¹⁴ Members should note that the standard examination window in CRD applicable to a particular registration category will apply notwithstanding the 12-month examination window established for purposes of the transition period. The 12-month examination window is only for the Operations Professional qualification examination. Thus, a person who elects to qualify, for example, by passing the Series 7 examination would have only 120 days to take and pass the Series 7 examination once the window for such examination is opened in CRD. Members should plan accordingly so that associated persons are prepared to take the requisite examination within the prescribed window for that registration category, and that any requisite examination is passed before the expiration of the 12-month transition period for Day-One Professionals.

the effective date of the proposed rule change who will be placed in such roles) (“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. The 60-day identification period and the 12-month transition period do not affect the obligations of non-Day-One Professionals to register as an Operations Professional prior to engaging in functions that would require such registration. However, any non-Day-One Professional associated with a non-clearing member who must pass the Operations Professional qualification examination (or an eligible qualification examination) to obtain registration would be granted a grace period of 120 days beginning on the date such person requests Operations Professional registration via Form U4 in CRD to pass such qualifying examination, during which time such person may function as an Operations Professional. FINRA believes that allowing a person associated with a non-clearing member to function as an Operations Professional for a 120-day period will enable these firms to manage their more limited staffs to comply with the proposed registration requirements without disrupting those firms’ obligations to customers. Non-Day-One Professionals associated with a self-clearing or clearing member would not have the benefit of the 120-day grace period and would be required to register as an Operations Professional prior to engaging in activities that would require such registration.

Members would be responsible for tracking and monitoring their associated persons to ensure that such persons are registered, and conducting their activities, in compliance with the time frames described above.

G. FINRA Continuing Education Rule

The proposed rule change would adopt NASD Rule 1120 (Continuing Education Requirements) as new FINRA Rule 1250 (Continuing Education Requirements). In addition to the proposed change noted in Section E., which would expand the scope of “covered registered persons” subject to the Firm Element to include persons registered as Operations Professionals, the proposed rule change would make additional minor changes to NASD Rule 1120 to update cross-references and reflect the conventions of the consolidated FINRA Rulebook.

NASD Rule 1120 and Incorporated NYSE Rule 345A were adopted in 1995 in response to the recommendation of a task force, which subsequently became the Securities Industry Regulatory Council on Continuing Education (the “Council”),¹⁵ to create uniform continuing education requirements in the securities industry. As advised by the Council, the continuing education requirements include a Regulatory Element and a Firm Element. The NASD and Incorporated NYSE rules are nearly identical in keeping with the goals of the Council to create uniform continuing education requirements.¹⁶

The Regulatory Element consists of periodic computer-based training on regulatory, compliance, ethical, supervisory subjects and sales practice standards. A registered person is required to participate and complete a designated Regulatory Element

¹⁵ The Council is comprised of up to 16 industry members from broker-dealers, representing a broad cross section of industry firms, and representatives from SROs as well as liaisons from the SEC and the North American Securities Administrators Association (“NASAA”).

¹⁶ The proposed rule change would not delete Incorporated NYSE Rule 345A (and its Interpretation). Rather, FINRA expects to address Incorporated NYSE Rule 345A (and its Interpretation) and propose additional changes to proposed FINRA Rule 1250 as part of the consolidated registration and qualification rules. See Regulatory Notice 09-70 (December 2009).

within a 120-day period that commences with the second anniversary of such person's initial securities registration, and reoccurs every three years thereafter for as long as such person remains in the securities business. Failure to complete the Regulatory Element will result in a registered person's registration becoming inactive and such person cannot conduct a securities business on behalf of the member until the requirement is met.¹⁷

The Firm Element requirements currently apply to any person registered with a member who has direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, any person registered as a research analyst pursuant to NASD Rule 1050, and to the immediate supervisors of such persons (collectively, "covered registered persons"). However, as noted above, the proposed rule change would expand the scope of "covered registered persons" subject to the Firm Element to include persons registered as Operations Professionals. The Firm Element consists of annual, member-developed and administered training programs designed to keep covered registered persons current regarding securities products, services and strategies offered by the member. The Firm Element requires members to annually evaluate and prioritize their training needs (i.e., conduct a Needs Analysis and develop a written plan). In planning, developing and implementing the Firm Element training, each member must take into consideration its size, organizational structure, scope of business, types of products and services it offers, as well as regulatory developments and the

¹⁷ A registered person will be required to retake the Regulatory Element in the event such person is: (1) subject to a statutory disqualification as defined by Section 3(a)(39) of the Exchange Act; (2) subject to a suspension or imposition of a fine of \$5,000 or more by an SRO or other securities governmental agency; or (3) ordered to do so as a sanction in a disciplinary action by an SRO or other securities governmental agency.

performance of its covered registered persons in the Regulatory Element. FINRA may require a member to provide specific training to a member's covered registered persons as FINRA deems appropriate. Each member must administer its Firm Element Continuing Education Program in accordance with its annual Needs Analysis and written plan, and must maintain records documenting the content of the program and completion of the program by covered registered persons.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 240 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁸ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes the proposed rule change to expand FINRA's registration and continuing education requirements to Operations Professionals will help ensure that investor protection mechanisms are in place in all areas of a member's business that could harm the member, a customer, the integrity of the marketplace, or the public.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

¹⁸ 15 U.S.C. 78o-3(b)(6).

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in Regulatory Notice 10-25 (May 2010) (the “Notice”). Forty-nine comment letters were received in response to the Notice.¹⁹ A copy of the Notice is attached as Exhibit 2a. A list of the comment letters received in response to the Notice is attached as Exhibit 2b. Copies of the comment letters received in response to the Notice are attached as Exhibit 2c. Below is a summary of the comments and FINRA’s responses.

General Concerns Regarding the Scope of the New Registration Category

Certain commenters generally opposed the proposed rule change stating that it is overly broad and ambiguous, poorly defined, imposes requirements that are unnecessary to meet FINRA’s stated objectives and may have unintended consequences.²⁰ Other commenters argued that licensing requirements do not make people honest or increase their efficiency or proficiency²¹ and that no amount of licensing will change failures of human character.²² Two commenters noted that frauds are almost always committed on the frontlines by individuals who are already licensed.²³ Additionally, certain commenters opposed registration requirements for covered persons because their work is

¹⁹ All references to the commenters under this Item are to the commenters as listed in Exhibit 2b.

²⁰ ACLI, AIC, Bank of America, Crowell, ESI, Horace Mann, IPA, IRI, Modern Woodmen, Navidar, NSCP, PSD, Quasar, UPFS, Scottrade, SIFMA, Sutherland, TIAA, Wellington and Wells Fargo.

²¹ Mutual Trust.

²² AIC and Wells Fargo.

²³ AIC and PSD.

already supervised and approved by a firm principal²⁴ and holding principals accountable for failures in these areas would be more cost effective.²⁵ Numerous commenters proposed an alternative approach under which firms would delegate each of the covered functions to existing registered principals of the firm and reflect such assignments in the firm’s written supervisory procedures (“WSPs”).²⁶ Other commenters noted the proposed rule change is unnecessary because people who handle customer funds go through background checks and fingerprinting.²⁷

In response, FINRA notes that covered persons are performing regulated broker-dealer functions on behalf of a member, and believes such persons should be subject to registration, examination and continuing education requirements to ensure that they attain and maintain specified levels of competence and knowledge to properly carry out their responsibilities to the member and its customers. FINRA does not agree that principal approval or background checks and fingerprinting are sufficient safeguards to ensure members’ operations departments are functioning in a manner that will promote investor protection to the highest level possible. The proposed rule change is intended, among other things, to increase covered persons’ awareness and knowledge that they are operating in a regulated environment designed to protect investors’ interests and the integrity of the operations of a broker-dealer. In addition, the proposed rule will help to ensure that any fraudulent activity that may start in the front office of a firm cannot be

²⁴ Crowell, IRI, M. Griffith, PSD and RiverStone.

²⁵ Crowell and Wellington.

²⁶ IRI, Nationwide, PSD and Sutherland.

²⁷ PSD, RiverStone and Wells Fargo.

processed without passing through a properly registered and trained Operations Professional. Requiring registration, testing and training for Operations Professionals should further strengthen members' compliance with securities laws, rules and regulations.

Certain commenters expressed concern that requiring registration of covered persons will dramatically limit the pool of candidates that may be considered for hiring when personnel changes occur in operations departments.²⁸ As an initial matter, FINRA notes that it is always correct to state that conduct once regulated becomes constrained by that regulation, but that observation by itself is not a credible reason not to engage in the regulation. The proper test is whether that regulation is appropriately tailored and needed in furtherance of the interests of investors and the securities markets. The immediate prior paragraph restates those interests, and the depth of personnel as set forth in Section A. of the Purpose section demonstrates the appropriate tailoring of the proposed regulation. Finally, Section D. of the Purpose section indicates that many candidates for positions that would require registration may possess an eligible registration and qualify for an exception from the requirement to take the Operations Professional qualification examination.

Two commenters suggested FINRA reduce the obligations for Operations Professionals and specify that not all of the rules applicable to associated persons apply to such persons since they are generally not customer-facing personnel.²⁹ Certain other commenters sought clarification that the proposed rule change does not eliminate or limit

²⁸ NPB and RiverStone.

²⁹ TIAA and Wells Fargo.

the ability of a securities issuer and its associated persons to rely on the issuer exemption under Exchange Act Rule 3a4-1³⁰ to avoid broker-dealer registration requirements.³¹

Another commenter requested that FINRA provide guidance on the impact of the proposed rule change on FINRA Rule 2310 (Direct Participation Programs) and clearly state that the salaries of Operations Professionals be categorized as “non-transaction-based-compensation” and that there is a blanket exception from “underwriting compensation” for Operations Professionals.³²

FINRA does not agree that Operations Professionals should be subject to a limited set of rules. Covered persons are not only associated persons of a member but their activities are crucial enough to the business of a member to require registration with FINRA. The proposed rule change does not alter a person’s status as an associated person under Exchange Act Rule 3a4-1 or otherwise, nor does it address the definitions of certain types of compensation under FINRA rules. However, FINRA recognizes that additional guidance may be needed following the adoption of the proposed rule change and will address interpretive questions as needed, similar to FINRA’s approach to other regulatory initiatives with wide-ranging and novel impacts.

Covered Persons for Inclusion in the New Registration Category

Certain commenters requested clarification with respect to proposed FINRA Rule 1230(b)(6)(A)(i) regarding scope of the term senior management and whether this provision applies beyond senior managers with primary or direct responsibility over the

³⁰ 17 CFR § 240.3a4-1.

³¹ PSD, Sutherland and TIAA.

³² IPA.

covered functions.³³ Two commenters advocated limiting the depth of personnel for the proposed rule change to a single category for senior management with responsibility over the covered functions, and requiring firms to maintain policies and procedures reasonably designed to ensure that operations personnel have an awareness of investor protection mechanisms in place at a firm.³⁴

FINRA believes this provision is clear as originally proposed and, while FINRA understands titles may differ between firms, members should be able to identify operations personnel that would be subject to proposed Rule 1230(b)(6)(A)(i) based on their functions and responsibilities as senior managers overseeing the covered functions. FINRA would consider any senior manager in the chain of command responsible for a covered function to be subject to the proposed rule, up to and including the Principal Operations Officer.³⁵ FINRA does not agree that “covered persons” should be limited to senior management with responsibility over the covered functions because the proposed registration category is intended to include other individuals who exercise supervisory and discretionary authority in direct furtherance of the covered functions. Accordingly, FINRA has not proposed changes to proposed FINRA Rule 1230(b)(6)(A)(i).

Proposed FINRA Rule 1230(b)(6)(A)(ii) would include as covered persons supervisors, managers or other persons responsible for approving or authorizing work, including work of other persons, in direct furtherance of the covered functions. One

³³ IRI, Nationwide, NSCP and TIAA.

³⁴ Wellington and Wells Fargo.

³⁵ See Regulatory Notice 09-70 (December 2009) for a discussion of the Principal Operations Officer registration category. See also infra note 61 and accompanying text.

commenter suggested the proposed rule explicitly state that covered persons are limited to those persons with decision-making and/or oversight authority.³⁶ Certain commenters requested that FINRA clarify what is meant by the phrase “approve or authorize work.”³⁷ Other commenters stated that this provision is written too broadly;³⁸ creates potential for misinterpretation in determining how far up or down the reporting chain this registration requirement would apply;³⁹ could sweep in affiliate employees, mid or low level employees,⁴⁰ third-party vendors⁴¹ and margin clerks;⁴² and that it should be limited to supervisors, managers or other persons responsible for primary oversight of covered functions, including managers for dual hat employees.⁴³ One commenter suggested that FINRA revise this provision to clarify that supervisors and managers be senior members of their respective departments or units.⁴⁴ Numerous commenters recommended deleting the phrase “work of other persons” because it is unclear.⁴⁵

³⁶ Morgan Stanley.

³⁷ ESI, NFP, TIAA and UPFS.

³⁸ ACLI, NSCP, Quasar and Wells Fargo.

³⁹ ACLI.

⁴⁰ Morgan Stanley.

⁴¹ Schwab.

⁴² Scottrade.

⁴³ ARM, TIAA and Wells Fargo.

⁴⁴ Bank of America.

⁴⁵ Bank of America, IPA, SIFMA and Wells Fargo.

FINRA believes proposed FINRA Rule 1230(b)(6)(A)(ii) is clear as proposed and notes that it consulted with industry representatives in developing the proposed rule change, including the definition and appropriate depth of personnel to be subject to the Operations Professional registration category. As noted above, FINRA believes members will be able to identify supervisors, managers or other persons responsible for approving or authorizing work in direct furtherance of the covered functions based on their functions and responsibilities. The phrases “approve or authorize work” and “work of other persons” are not legal terms of art but, rather, comport with commercially understood operating terms and do not require clarification. Accordingly, FINRA has not revised this provision as suggested by the commenters; however, FINRA proposes a minor modification to the original proposal by re-locating the phrase “including the work of other persons” to streamline the provision, as reflected in Section A. of the Purpose section.

As originally proposed in the Notice, FINRA Rule 1230(b)(6)(A)(iii) required registration as an Operations Professional for persons with the authority or discretion to commit the member’s capital in direct furtherance of the covered functions or to commit the member to any contract or agreement (written or oral) in direct furtherance of the covered functions. Certain commenters stated this provision is unclear and too far-reaching⁴⁶ and noted it would capture persons who perform routine, daily activities, or enter into agreements consistent with firm policies that have no material impact on firm operations (including margin clerks, who often have flexibility to obligate firm capital up

⁴⁶ Bank of America, TIAA and NSCP.

to certain limits).⁴⁷ Two commenters noted that the provision should only be triggered if the contracts are sufficiently material to the firm.⁴⁸ One commenter noted that it may be so broad as to require registration of junior associates if they sign or approve contracts, retain vendors or make clerical postings to the books of a member.⁴⁹ Another commenter noted that this provision is inconsistent with the first two categories of covered persons, which focus on senior managers, supervisors and those who approve work in the covered functions.⁵⁰ Another commenter requested clarification with respect to the term “firm capital” because it could sweep in persons who approve the payment of vendor invoices for services related to some aspect of a covered function.⁵¹ Two commenters noted it is unclear what individuals, other than those engaged in or supervising securities lending activities, the proposed third category of covered persons intends to cover and suggested certain amendments to clarify the proposal with respect to such persons.⁵²

Based on the comments, FINRA has revised the third category of covered persons from the original proposal in the Notice, as discussed in Section A of the Purpose section. Under the revised proposal, FINRA Rule 1230(b)(6)(A)(iii) would require 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

⁴⁷ T. Rowe Price and Wells Fargo.

⁴⁸ Bank of America and TIAA.

⁴⁹ Bank of America.

⁵⁰ SIFMA.

⁵¹ Scottrade.

⁵² Morgan Stanley and SIFMA.

(written or oral) in direct furtherance of the covered functions to register as an Operations Professional. FINRA purposefully did not limit the third category of covered persons to supervisors and managers because the capacity to make material discretionary decisions above a member's pre-established spending guidelines and risk management policies under this provision is not confined to senior or supervisory personnel.

Numerous commenters suggested that FINRA add language to the proposed rule to clarify, as stated in the Notice, that the proposed rule does not apply to persons who perform functions 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, such as internal audit, legal or compliance personnel.⁵³ One commenter further urged FINRA to add rule language to note that individuals performing quality assurance and quality control functions in direct furtherance of a covered function are similarly excluded.⁵⁴ One commenter noted that registering clerical personnel only increases costs unnecessarily and creates hiring barriers for new applicants.⁵⁵ One commenter requested that FINRA provide specific examples of activities it deems ministerial or clerical in nature, especially when such activities require Financial and Operations Principal review and control procedures.⁵⁶

Based on the comments, and as noted in Section A. of the Purpose section of this rule filing, FINRA is proposing supplementary material .06 to the proposed rule to clarify

⁵³ Bank of America, FSI, NSCP, Scottrade, SIFMA and TIAA.

⁵⁴ TIAA.

⁵⁵ Martin Nelson.

⁵⁶ Quasar.

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 would not be required to register as an Operations Professional. FINRA declines to provide examples of clerical and ministerial activities at this time, believing the term to be well understood in the industry;⁵⁷ however, as noted above, FINRA will consider issuing additional guidance as needed regarding the categories of persons subject to the Operations Professional registration category.

One commenter encouraged FINRA to clarify whether an Operations Professional must be supervised by a qualified supervisory principal.⁵⁸ Another commenter requested clarification regarding whether a firm must assign or designate an Operations Professional and whether a person who is already a registered principal must register as an Operations Professional.⁵⁹

As noted above, as registered persons, Operations Professionals will be subject to all FINRA rules applicable to associated persons and/or registered persons. Accordingly, pursuant to NASD Rule 3010(a)(5), each Operations Professional must be assigned to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities. Additionally, FINRA expects that each member

⁵⁷ See, e.g., NASD Rule 1060 (Persons Exempt from Registration).

⁵⁸ Pershing.

⁵⁹ Crowell.

would have at least one registered Operations Professional, who often may be the member's Financial and Operations Principal and/or the Principal Operations Officer. In this regard, neither principal registration, nor representative registration in another category, obviates the requirement for a covered person to register as an Operations Professional. As noted in Section D. of the Purpose section, there are numerous eligible registrations that would except such registered persons from the requirement to pass the Operations Professional qualification examination.

Certain commenters inquired as to the proposed rule change's relationship to, and consistency with, the proposals set forth in Regulatory Notice 09-70⁶⁰ and two commenters requested clarification regarding how the proposed requirement under Regulatory Notice 09-70 that firms appoint a distinct Principal Operations Officer and a distinct Principal Financial Officer intersects with the proposed Operations Professional designation.⁶¹

The proposed rule change does not conflict with the proposals set forth in Regulatory Notice 09-70. The proposed rule change should be read as a separate registration requirement that will be added to the consolidated FINRA registration rules. To note, the proposed rule change would include persons engaged in or supervising stock loan/securities lending activities that meet the depth of personnel as a covered person in Section A. above. FINRA also is proposing separate registration requirements for a "Securities Lending Representative" and a "Securities Lending Supervisor" in Regulatory Notice 09-70; consequently, firms should be aware of both sets of proposed

⁶⁰ PSD, Sutherland and Wells Fargo.

⁶¹ IRI and TIAA.

requirements.⁶² With respect to the proposed requirements in Regulatory Notice 09-70 for Principal Operations Officers and Principal Financial Officers, such persons likely would be required to register as an Operations Professional, depending on whether they meet the criteria of a covered person as described in Section A. of the Purpose section. The requirement for a covered person to register as an Operations Professional applies regardless of any other, separate registration requirements; however, such other registration may be used as an eligible registration to qualify a covered person for an exception from the requirement to take the Operations Professional qualification examination.

One commenter noted the proposed rule change could have costly and burdensome implications regarding state registration and licensing so FINRA should be as clear as possible in defining who is covered under the proposed rule change.⁶³ As noted above, FINRA believes the definitions of covered persons are sufficiently clear and will provide additional guidance as needed regarding the scope of persons subject to the new requirements.

Covered Functions for Inclusion in the New Registration Category

Numerous commenters stated that the covered functions as proposed in the Notice are too broad, unclear and inconsistent, and will incur unnecessary costs for firms.⁶⁴ The

⁶² See supra note 5.

⁶³ NSCP.

⁶⁴ Commonwealth, Crowell, ESI, FSI, IPA, IRI, Modern Woodmen, Morgan Stanley, NFP, Northwestern Mutual, NSCP, PSD, TIAA, SIFMA, Sutherland, UPFS and WSFG.

commenters requested more precise descriptions of the covered functions.⁶⁵ One commenter requested that FINRA clarify that the covered functions apply only to activities performed by or on behalf of a firm’s securities and investment banking business.⁶⁶ Two commenters urged FINRA to group dependent technology-related covered functions into a single entry.⁶⁷ Another commenter suggested that certain functions be deleted because they are roles that support other covered functions and are not stand-alone functions.⁶⁸

Based on the comments, FINRA has made certain changes to the covered functions as originally proposed in the Notice to clarify and streamline the proposed rule. As a general matter, FINRA has revised the list of covered functions, as reflected in Section B. of the Purpose section, to group related functions together. Substantive revisions to the covered functions are described in detail below.

To clarify the proposed rule change, FINRA has revised Rule 1230(b)(6)(B)(i) (as originally proposed in the Notice) by limiting this covered function to the “[a]pproval of pricing models used for valuations,” instead of the “[d]evelopment and approval of pricing models used for valuations.” FINRA also moved this provision to proposed Rule 1230(b)(6)(B)(x).

⁶⁵ Commonwealth, Crowell, ESI, FSI, IPA, IRI, Modern Woodmen, Morgan Stanley, NFP, Northwestern Mutual, NSCP, PSD, TIAA, SIFMA, Sutherland, UPFS and WSFG.

⁶⁶ TIAA.

⁶⁷ Morgan Stanley and NSCP.

⁶⁸ Schwab.

Two commenters requested a definition for the term “client on-boarding” in proposed FINRA Rule 1230(b)(6)(B)(v) (as originally proposed in the Notice).⁶⁹ FINRA notes from its consultation with industry representatives in the rule development process that this is a term commonly used for this covered function and believes the proposed rule text provides sufficient clarity (i.e., “[c]lient on-boarding (customer account data and document maintenance)”).

Numerous commenters requested clarification with respect to the scope of proposed FINRA Rule 1230(b)(6)(B)(vi) (as originally proposed in the Notice), the covered function addressing the “[c]apturing of 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.”⁷⁰ One commenter noted that this provision should apply only to individuals who “define and approve” business requirements, rather than individuals who “capture” such requirements.⁷¹ Similarly, to reduce the likelihood of inadvertently capturing personnel who merely prepare initial drafts of business requirements documents and who perform routine quality assurance or quality control testing, two commenters suggested incorporating the concepts of “accepting” and “approving” in lieu of “capturing” and “defining” for the covered functions that include these terms.⁷²

⁶⁹ PSD and Sutherland.

⁷⁰ ESI, FSI, Horace Mann, Modern Woodmen, NFP, Scottrade, TIAA and UPFS.

⁷¹ Northwestern Mutual.

⁷² Bank of America and SIFMA.

Based on the comments, FINRA has revised the original proposal to eliminate the concept of “capturing” in proposed FINRA Rule 1230(b)(6)(B)(vi). The proposed rule change renumbers this provision as proposed FINRA Rule 1230(b)(6)(B)(xiii) and includes as a covered function, “[d]efining 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.” FINRA has not eliminated the concept of “defining” from the covered functions because it believes covered persons who are responsible for defining and approving business system requirements are professional level staff that should be subject to registration with FINRA. The covered functions generally would not include a person who engages in administrative responsibilities, such as an initial drafter or a code developer. However, a person who supervises or approves such activities generally would be required to register as an Operations Professional.

Additionally, certain commenters requested clarification with respect to proposed Rule 1230(b)(6)(B)(vii) (as originally proposed in the Notice), which includes as a covered function, “[w]ith respect to the covered functions, defining and approving business security requirements and policies for information technology (including, but not limited to, systems and data).”⁷³ One commenter noted that this function should only require persons who “approve” business requirements for systems and information technology to register so that the final approvals for technology requirements are performed by licensed Operations Professionals.⁷⁴

⁷³ ESI, FSI, Horace Mann, Modern Woodmen, NFP, Scottrade and UPFS.

⁷⁴ Morgan Stanley.

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.

One commenter requested clarification with respect to proposed Rule 1230(b)(6)(B)(viii) (as originally proposed in the Notice), which includes as a covered function, “[d]efining information entitlement policy in connection with the covered functions.”⁷⁵

Based on the comments and in line with the changes noted above, FINRA has revised Rule 1230(b)(6)(B)(viii). The proposed rule change renumbers this provision as proposed FINRA Rule 1230(b)(6)(B)(xv) and includes as a covered function, “[d]efining and approving information entitlement policies in connection with the covered functions.”

One commenter recommended that FINRA combine paragraphs (b)(6)(B)(vii) and (viii) (as originally proposed in the Notice) since both sections cover overlapping sets of supervisors in the Information Management area.⁷⁶ Another commenter noted that proposed FINRA Rules 1230(b)(6)(B)(vi), (vii), (viii) and (xv) are not separate functions

⁷⁵ Scottrade.

⁷⁶ Bank of America.

but are ancillary to other covered functions and may require managers from both the actual covered functions and these ancillary areas to register.⁷⁷ One commenter requested clarification that FINRA Rules 1230(b)(6)(B)(vi), (vii) and (viii) (as originally proposed in the Notice) are limited to only those individuals directly employed by the FINRA member.⁷⁸ Another commenter suggested limiting these provisions to individuals responsible for ensuring that systems related to sales and trading and to covered functions meet business and regulatory requirements and “information security” (firewalls, data access, and system entitlements in connection with the covered functions).⁷⁹

FINRA believes that the proposed revisions to these provisions noted above clarify the proposed rule and is not proposing further changes at this time. FINRA notes that these covered functions should remain as separate items since they address different activities (e.g., defining, approving and validating business requirements for sales and trading systems or other systems relating to the covered functions vs. defining and approving entitlement policies in connection with the covered functions) and firms may have different internal reporting structures so that these activities are not part of the same area or subject to the same supervisory scheme.

Certain commenters suggested deleting proposed Rule 1230(b)(6)(B)(xv) (as originally proposed in the Notice), which includes as a covered function, “[p]osting entries to the books and records of a member in connection with the covered functions,”

⁷⁷ NSCP.

⁷⁸ IPA.

⁷⁹ SIFMA.

because it is ambiguous, too broad⁸⁰ and may sweep in clerical staff.⁸¹ Another commenter requested clarification regarding the term “books and records” and requested that FINRA add a reference to Exchange Act Rule 17a-3⁸² or MSRB Rule G-8.⁸³ Two commenters recommended that FINRA revise this provision to tailor it to separate regulatory issues such as customer protection or financial responsibility concerns.⁸⁴

FINRA has revised Rule 1230(b)(6)(B)(xv) to clarify this covered function. The proposed rule change renumbers this provision as FINRA Rule 1230(b)(6)(B)(xvi) and includes as a covered function, “[p]osting 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.”

One commenter noted that some of the covered functions may cause confusion with respect to other registration categories, including proposed FINRA Rules 1230(b)(6)(B)(ix) and (xiv) (as originally proposed in the Notice), the covered functions for “[f]inancial controller (including general ledger)” and “[f]inancial regulatory reporting,” respectively, and the functions supervised by the financial and operations principal, and may overlap with the proposed designation of the Principal Operations Officer under Regulatory Notice 09-70.⁸⁵ Based on the comment, FINRA has revised

⁸⁰ Bank of America and SIFMA.

⁸¹ Crowell and SIFMA.

⁸² 17 CFR § 240.17a-3.

⁸³ Rockfleet.

⁸⁴ Morgan Stanley and SIFMA.

⁸⁵ IRI.

these items. The proposed rule change renumbers these items as proposed FINRA Rules 1230(b)(6)(B)(xi) and (xii), respectively, and includes as covered functions, “[f]inancial control, including general ledger and treasury” and “[c]ontributing to the process of preparing and filing financial regulatory reports.” FINRA does not agree that the proposed rule change causes confusion with respect to other registration requirements. Members must determine whether the proposed registration requirements for Operations Professionals would apply to an associated person based on his or her functions and responsibilities notwithstanding any other, separate registration requirements.

One commenter noted that the title of the proposed registration category is too narrow and not reflective of the covered functions. Alternatively, the commenter suggested that the registration category should be titled “Operations, Support or Securities Lending Professionals.”⁸⁶ FINRA believes that the proposed title for the new registration category, Operations Professionals, is appropriate and succinctly captures the individuals to which the proposed requirements would apply given the breadth of activities covered under the proposed rule change.

Certain commenters requested clarification that ongoing insurance company functions relating to variable annuity contracts as well as other functions performed by insurance company staff are not included in the covered functions.⁸⁷ FINRA does not intend to make any categorical exclusions from the covered functions. The proposed requirements will apply if a person meets the depth of personnel criteria and engages in

⁸⁶ SIFMA.

⁸⁷ IRI, PSD and Sutherland.

one or more covered function on behalf of a member regardless of where they are employed.

Operations Professional Qualification Examination

One commenter noted that elements of the qualification examination and continuing education requirements have no relevance to the products and operations of limited purpose broker-dealers that comprise more than 50% of FINRA’s membership.⁸⁸ Other commenters noted that the two areas of proposed examination coverage, “essential product and market knowledge for an Operations Professional” and “knowledge associated with operations activities,” should be eliminated from the examination curriculum because they undercut FINRA’s premise that it will not be a “competency” examination and render the test extremely challenging for many operations personnel since they lack the background and experience to pass the examination and have little testing experience.⁸⁹ Another commenter similarly noted that the proposed examination requirement could result in well-qualified employees losing their jobs and firms’ operations departments could have compromised functionality, and supervision (*i.e.*, a “brain drain”) of qualified operations personnel, thus undermining the goals of the proposal.⁹⁰

Numerous commenters stated that an examination is unnecessary because training and education for operations personnel should be addressed in a member’s WSPs⁹¹ and

⁸⁸ ACLI.

⁸⁹ NSCP and ACLI.

⁹⁰ NSCP.

⁹¹ FSI, M. Griffith, Navidar and PSD.

registered principals are responsible for training operations personnel.⁹² To reduce cost burdens on firms, certain commenters recommended ongoing training requirements as an alternative to registration and testing of operations personnel.⁹³ Certain other commenters noted that FINRA can address operations personnel through registration and continuing education⁹⁴ and an examination not based on competency serves no essential function.⁹⁵ One commenter stated that the Series 27 and 28 examinations already test for the covered functions, so a new exam is a poor use of member firm fees and will unnecessarily delay implementation of the proposal.⁹⁶

One commenter noted that based on the definition of a covered person, the Operations Professional qualification examination should be a principal-level examination with corresponding continuing education requirements.⁹⁷ One commenter requested that FINRA publish a study outline for notice and comment prior to making the test effective.⁹⁸ Another commenter recommended that FINRA offer the proposed

⁹² Modern Woodmen and Martin Nelson.

⁹³ Harrison, NSCP, RMOA and Wells Fargo.

⁹⁴ Commonwealth, ESI, FSI, Horace Mann, NFP, UFPS and WSFG.

⁹⁵ Horace Mann, JRCO, Modern Woodmen, NSCP, RMOA, Rockfleet, UPFS and WSFG.

⁹⁶ Rockfleet.

⁹⁷ Rockfleet.

⁹⁸ NSCP.

examination as an optional test for people who want to learn about back-office, but not as a mandatory examination for Operations Professional registration.⁹⁹

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)).

One commenter suggested that FINRA modify the period for retaking the Operations Professional qualification examination if an applicant fails to 30 days like the Series 55.¹⁰⁰ FINRA does not intend to change its policy regarding the re-taking of qualification examinations for the proposed Operations Professional examination at this

⁹⁹ M. Griffith.

¹⁰⁰ Schwab.

time. FINRA will reconsider the policy if it finds it to be a necessary step when the qualification examination for Operations Professionals is administered.

Exception to Operations Professional Examination Requirement

One commenter noted that the proposed exceptions are so numerous that they dilute the regulatory intent of the proposed rule change; instead, FINRA should grant a limited number of exceptions to current operations employees.¹⁰¹ One commenter recommended FINRA incorporate an exception for certain small firms.¹⁰² One commenter suggested that registered principals should be completely exempt from the proposed Operations Professional requirements;¹⁰³ other commenters suggested that the proposed rule change should only apply to currently unregistered persons because the potential costs and burdens involved with tracking and monitoring multiple registrations outweigh the benefits.¹⁰⁴ One commenter suggested FINRA permit firms to identify any relied upon registration for the proposed exception in their WSPs instead of a U4 amendment, as is required currently for any person in a supervisory role.¹⁰⁵

Certain other commenters recommended a grandfather provision for experienced persons who have worked in operations areas for a certain time period (e.g., three¹⁰⁶ or

¹⁰¹ NASAA.

¹⁰² Freestone.

¹⁰³ NSCP.

¹⁰⁴ Northwestern Mutual and T. Rowe Price.

¹⁰⁵ T. Rowe Price.

¹⁰⁶ Commonwealth.

five¹⁰⁷ years) prior to the implementation of the proposed rule.¹⁰⁸ Two commenters requested that FINRA extend the proposed exception to registrations held beyond the two-year look back.¹⁰⁹ One commenter noted that there are costs and burdens of a two-year look back without a concomitant benefit.¹¹⁰ Additionally, one commenter suggested that FINRA consider incorporating standards within its Qualification Examination Waiver Guidelines that will accommodate individuals that possessed an eligible registration within a reasonably recent time period and have been performing an Operations Professional role for a reasonable period of time.¹¹¹ This commenter also suggested that FINRA finalize the permissive registration regime contemplated in Regulatory Notice 09-70 prior to implementing a new Operations Professional designation, which would provide firms and their personnel with the option to maintain licenses while the registered person occupies a non-registered position.¹¹²

¹⁰⁷ FSI, PSD and Sutherland.

¹⁰⁸ FSI, Modern Woodmen, NFP, UPFS and WSFG.

¹⁰⁹ Nationwide and TIAA.

¹¹⁰ IRI.

¹¹¹ TIAA.

¹¹² TIAA.

FINRA believes the proposed rule change clearly articulates the exception to the Operations Professional qualification examination requirement.¹¹³ A primary purpose of the proposed qualification examination is to assess a covered person's basic understanding of the securities industry and the requirement to take a registration examination serves to alert such person of the role he or she plays in this highly regulated environment. Thus, FINRA believes the eligible registrations (and corresponding examinations) serve as a valid proxy for the Operations Professional examination requirement.

FINRA believes the two-year look back for the eligible registrations is appropriate and has not revised the proposal to extend this time period. The proposed look back is based on the window during which an associated person remains eligible to re-activate his or her registration based on previously qualifying for and holding such registration. A person who qualifies for the proposed exception based on their having held an eligible registration within the two years immediately prior to registering as an Operations Professional would be required to first re-activate such eligible registration prior to requesting Operations Professional registration.¹¹⁴ Under NASD Rules 1021 and 1031, members are permitted to maintain or make application for registration as a registered principal or registered representative for a person who performs back-office operations, among other things. As such, firms are not currently prohibited from carrying

¹¹³ The Notice included as an eligible registration the General Securities Principal – Sales Supervisor Module (Series 23). FINRA has removed this examination from the list of eligible registrations. A person who passes the Series 9/10 and the Series 23 may obtain the General Securities Principal (Series 24) registration, but a person who passes solely the Series 23 is not considered registered in any capacity.

¹¹⁴ See supra note 7.

registrations for back-office personnel. FINRA has determined not to incorporate a grandfather provision for previously unregistered operations personnel. FINRA believes that all covered persons benefit from an examination requirement even if they have been working in the same position for an extended period. As noted above, the proposed Operations Professional examination will not test on specific job functions but will focus on general securities industry knowledge and key regulatory themes.

Continuing Education

Certain commenters encouraged FINRA to clarify whether the proposal requires currently registered principals to take both the S101 continuing education module and the S201¹¹⁵ and requested that FINRA refine the continuing education requirements to reflect FINRA's diverse membership.¹¹⁶

As stated in the Notice and Section E. of the Purpose section, individuals who avail themselves of the proposed exception to the Operations Professional qualification examination requirement with an eligible registration would be subject to the Regulatory Element program appropriate for such other registration category. FINRA believes the proposed continuing education requirements for Operations Professionals are clear and notes that such requirements will be appropriately suited for those subject to registration, similar to the continuing education training for other FINRA registration categories.

Outsourced and Shared Functions

One commenter requested confirmation that FINRA does not intend to alter indirectly the definition of "associated person" or the existing regulatory guidance on

¹¹⁵ Great Nation.

¹¹⁶ ACLI.

outsourcing arrangements with the proposed rule change.¹¹⁷ Numerous commenters requested clarification that covered persons are limited to persons who have been empowered by a broker-dealer to oversee the covered functions and would not include individuals who perform operations functions for affiliated entities, outsourced operations functions for a third-party service provider or supervisors within a large, diversified financial services organization who are far-removed from a member's securities business.¹¹⁸ Certain commenters requested clarification with respect to who must register where clearing and introducing firms share responsibility for operations functions ("shared functions")¹¹⁹ and whether such persons would be considered associated persons of both the introducing and clearing firms.¹²⁰ Several commenters suggested that an exemption be provided when covered functions are performed by another registered broker-dealer, bank, investment advisor, foreign entity¹²¹ or affiliated insurance company.¹²² Given a member's obligation to supervise any outsourced activity, numerous commenters stated that it should be sufficient for FINRA to confine application of the proposed registration and examination requirements to "employees" of the

¹¹⁷ SIFMA.

¹¹⁸ ACLI, A&P, ARM, Bank of America, Horace Mann, IRI, Nationwide, PSD, Sutherland and TIAA.

¹¹⁹ ESI, FSI, NFP, UPFS, Wells Fargo and WSFG.

¹²⁰ Northwestern Mutual, Pershing and Wells Fargo.

¹²¹ AIC and Pershing.

¹²² ACLI and AIC.

member.¹²³ One commenter questioned the legal ramifications that would result from requiring the registration of vendor employees with more than one member.¹²⁴ Certain commenters requested clarification with respect to how the proposed rule change affects Office of Supervisory Jurisdiction (“OSJ”) requirements relating to currently outsourced activities¹²⁵ and back-office and support locations.¹²⁶ One commenter stated the proposed rule change would place an unfair burden on small firms that outsource many of the covered functions.¹²⁷

As noted above, 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.

¹²³ NSCP, Pershing, Schwab, Scottrade and TIAA.

¹²⁴ Pershing.

¹²⁵ IRI.

¹²⁶ Scottrade and TIAA.

¹²⁷ Zelman.

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),¹²⁸ 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.¹²⁹

One commenter suggested that treating persons that fall within the covered categories as associated persons of a member will impact state law prohibitions on dual registration and vendor agreements.¹³⁰ FINRA has stated throughout this filing the need for this proposed rule change and its belief that the proposal is appropriately tailored to meet its stated objectives. FINRA believes it is, therefore, required additional regulation. That being the case, ill-defined collateral effects that can be avoided by a member do not

¹²⁸ FINRA replaced NASD Rule 3230 (Clearing Agreements) and NYSE Rule 382 (Carrying Agreements) with new consolidated FINRA Rule 4311 (Carrying Agreements). See Securities Exchange Act Release No. 63999 (March 1, 2011) (Order Approving File No. SR-FINRA-2010-061).

¹²⁹ See supra note 61 and accompanying text.

¹³⁰ TIAA.

serve as a reason to modify or negate such proposed rulemaking. Finally, FINRA already views the persons treated as covered persons in the covered functions, and indeed all non-clerical persons reporting to such covered persons, as associated persons irrespective of this proposed rule.

Small Firms Concerns

Numerous commenters noted the proposed rule change places an undue burden on, unnecessarily increases costs for, and is anticompetitive for small firms with no apparent benefit to the public.¹³¹ One commenter noted the proposal is appropriate only in its application to personnel and broker-dealers that handle customer accounts, customer funds and/or securities.¹³²

FINRA does not agree that small firms would be overly burdened by the proposed rule change since almost all other FINRA registration requirements apply to small firms and do not provide an exemption for personnel performing activities that would require registration based on a firm's limited business. FINRA also anticipates that many persons who would be subject to the new Operations Professional registration category would qualify for the proposed exception from the qualification examination based on existing registrations, and, as noted above, FINRA would not assess a separate registration fee for persons relying on the proposed exception to register as Operations Professionals. Moreover, the impact of the proposed rule change is expected to be minimal as the majority of the covered functions are generally performed by the carrying

¹³¹ Crowell, Freestone, Martin Nelson, Mutual Trust, Navidar, RiverStone, Wellington and Zelman.

¹³² FirstBank PR.

and clearing firm and, as noted above, 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),¹³³ so FINRA would not expect dual registration as an Operations Professional in such cases. However, as further detailed in Section F. above, in light of the limitations on personnel at certain smaller firms, FINRA is proposing a 120-day grace period for covered persons associated with a non-clearing member to transition into the proposed registration category.

Implementation of the Proposed Rule Change

Numerous commenters suggested that the proposed transition period of six to nine months for persons acting as Operations Professionals as of the effective date of the proposed rule change is insufficient for firms to fully comply because a significant number of personnel will need to become registered. The commenters noted that firms will likely need to phase-in such persons' preparation for, and taking of, the qualification examination to mitigate the impact on customer service and operational functions.¹³⁴ Also, certain commenters suggested that personnel may not pass the qualification examination on the first attempt since good test preparation services may not be available and certain operations personnel may not have test-taking skills.¹³⁵ The commenters

¹³³ See supra note 128 and accompanying text.

¹³⁴ ARM, Bank of America, Commonwealth, ESI, FSI, Horace Mann, Modern Woodmen, M. Griffith, Morgan Stanley, NFP, NSCP, Scottrade, SIFMA and WSFG.

¹³⁵ Nationwide, UPFS and Wells Fargo.

suggested extending the transition period to between 12 to 18 months¹³⁶ or up to 24 months.¹³⁷ Other commenters noted that all persons should have the benefit of the transition period regardless of when they begin work in a covered function.¹³⁸

Certain commenters suggested that persons who begin work as Operations Professionals following the effective date of the proposed rule change (*i.e.*, new hires or associated persons who meet the depth of personnel and transfer into a covered function) should be granted a grace period to transition into the proposed registration category.¹³⁹ According to one commenter, subjecting these persons to the proposed licensing regime immediately undercuts the purpose of the transition period and may chill hiring of operations personnel while the transition period is in effect.¹⁴⁰ Numerous commenters recommended a 90-day grace period for new hires or those who transition into a covered function, consistent with current NASD Rule 1021(d), which generally allows a registered representative to act in a principal capacity for 90 days while preparing for an applicable exam.¹⁴¹ Two commenters suggested a 120-day grace period for personnel who transition into a covered function after the transition period has expired, conditioned

¹³⁶ ARM, Bank of America, Commonwealth, ESI, FSI, Horace Mann, Modern Woodmen, M. Griffith, Morgan Stanley, NFP, NSCP, Scottrade, SIFMA and WSFG.

¹³⁷ Schwab.

¹³⁸ Schwab, SIFMA and TIAA.

¹³⁹ IRI, Nationwide, NSCP, Scottrade and Wells Fargo.

¹⁴⁰ Morgan Stanley.

¹⁴¹ ARM, Bank of America, PSD, Schwab, Scottrade, Sutherland and Wells Fargo.

on supervision by a licensed Operations Professional.¹⁴² One commenter suggested a 180-day grace period.¹⁴³

Based on the comments, FINRA has amended the transition period that was proposed in the Notice. As further detailed in Section F. above, FINRA is proposing a 60-day identification period beginning on the effective date of the proposed rule change during which Day-One Professionals must request registration as an Operations Professional via Form U4 in CRD. Day-One Professionals who are identified during the 60-day period and must pass the Operations Professional examination (or an eligible qualification examination) would be granted 12 months beginning on the effective date of the proposed rule change to pass such qualifying examination, during which time such persons may function as an Operations Professional.

With respect to non-Day-One Professionals, any person associated with a clearing or self-clearing member must 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. Any non-Day-One Professional associated with a non-clearing member who must pass the Operations Professional qualification examination (or an eligible qualification examination) to obtain registration would be granted a grace period of 120 days beginning on the date such person requests Operations Professional registration via Form U4 in CRD to pass such qualifying examination, during which time such person may function as an Operations Professional.

¹⁴² Morgan Stanley and SIFMA.

¹⁴³ Wells Fargo.

Two commenters expressed sentiments regarding their general disagreement with FINRA spending¹⁴⁴ and the current regulatory structure for broker-dealers.¹⁴⁵ These comments are outside the scope of the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2011-013 on the subject line.

¹⁴⁴ Mutual Trust.

¹⁴⁵ Wellington.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2011-013. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All

submissions should refer to File Number SR-FINRA-2011-013 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴⁶

Cathy H. Ahn
Deputy Secretary

¹⁴⁶ 17 CFR 200.30-3(a)(12).