

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-80371; File No. SR-FINRA-2017-007)

April 4, 2017

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt Consolidated FINRA Registration Rules, Restructure the Representative-Level Qualification Examination Program and Amend the Continuing Education Requirements

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 28, 2017, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II 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 with amendments the NASD and Incorporated NYSE rules relating to qualification and registration requirements as FINRA rules in the Consolidated FINRA Rulebook.<sup>3</sup> The proposed rule change also restructures the current representative-level qualification examinations and creates a general knowledge examination and specialized

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> The current FINRA rulebook consists of: (1) FINRA rules; (2) NASD rules; and (3) Incorporated NYSE rules. While the NASD rules generally apply to all FINRA members, the Incorporated NYSE rules apply only to those members of FINRA that are also members of the NYSE (“dual members”). The FINRA rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

knowledge examinations. In addition, the proposed rule change amends the Continuing Education (“CE”) requirements.

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

Section 15A(g)(3) of the Act authorizes FINRA to prescribe standards of training, experience and competence for persons associated with FINRA members. Accordingly, FINRA has adopted registration requirements to ensure that associated persons attain and maintain specified levels of competence and knowledge pertinent to their function. The current FINRA registration rules include both NASD rules and rules incorporated from the NYSE (“Incorporated NYSE rules”).

In general, the current rules: (1) require that persons engaged in a member’s investment banking or securities business who are to function as representatives or principals register with

FINRA in each category of registration appropriate to their functions by passing one or more qualification examinations; (2) exempt specified associated persons from the registration requirements; and (3) provide for permissive registration of specified persons.

As part of the process of developing the Consolidated FINRA Rulebook, FINRA published Regulatory Notice 09-70 (December 2009), seeking comment on a set of proposed consolidated registration rules.<sup>4</sup> The proposed rules, among other changes, allowed any associated person to obtain and maintain any registration permitted by the member. FINRA also proposed adopting a Retained Associate (“RA”) status in the Central Registration Depository (“CRD<sup>®</sup>”) system for individuals who would be working for a financial services industry affiliate of a member, and who would not be working in any capacity for the member. Under the proposal, RAs would be able to obtain and maintain any registration permitted by the member, subject to specific requirements. Further, the proposal created an “active” and “inactive” registration status in the CRD system to distinguish between required and permissive registrations, including the proposed RA status. In addition, the proposal included several other substantive changes, such as adoption of a Compliance Officer registration category for Chief Compliance Officers (“CCOs”), designation of a Principal Financial Officer and Principal Operations Officer, enhancement of the examination requirements for Research Principals, adoption of registration categories for Supervisory Analysts, Securities Lending Representatives and Securities Lending Supervisors, imposition of an experience requirement for representatives functioning as principals for a limited period before passing a principal examination and elimination of the Foreign Associate registration category.

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<sup>4</sup> In addition, FINRA had proposed to transfer NASD Rule 3010(e) relating to background checks on registration applicants into the Consolidated FINRA Rulebook as a FINRA rule. FINRA adopted NASD Rule 3010(e) as FINRA Rule 3110(e) as part of a separate proposed rule change. See Regulatory Notice 15-05 (March 2015).

As discussed in Item II.C. below, commenters were concerned with the complexity and operational and cost burden of the RA proposal. FINRA also engaged in discussions with SEC staff regarding the impact of the RA proposal. As a result, FINRA has revised the proposal as published in Regulatory Notice 09-70. Specifically, rather than allowing individuals to obtain and maintain their registrations based on an RA status, the proposed rule change establishes a process whereby individuals who would be working for a financial services industry affiliate of a member would terminate their registrations with that member and would be granted a waiver of their qualification requirements upon re-registering with a member, provided the firm that is requesting the waiver and the individual satisfy specified conditions. FINRA has also eliminated the proposal to create an “active” and “inactive” registration status in the CRD system to distinguish between required and permissive registrations. Further, FINRA is no longer proposing to establish registration categories for Securities Lending Representatives and Securities Lending Supervisors.

FINRA administers qualification examinations that are designed to establish that persons associated with FINRA members have attained specified levels of competence and knowledge. The first of these examinations was established in 1956. Over time, the examination program has increased in complexity to address the introduction of new products and functions, and related regulatory concerns and requirements. As a result, today, there are a large number of examinations, considerable content overlap across the representative-level examinations and requirements for individuals in various segments of the industry to pass multiple examinations.

To address these issues, FINRA published Regulatory Notice 15-20 (May 2015), seeking comment on a proposal to restructure the current representative-level qualification examination

program<sup>5</sup> into a more efficient format whereby all potential representative-level registrants would take a general knowledge examination called the Securities Industry Essentials™ (“SIE™”) and a tailored, specialized knowledge examination for their particular registered role. The proposal, among other things, eliminates duplicative testing of general securities knowledge on examinations. The proposal also eliminates several representative-level registration categories and associated examinations that have become outdated or have limited utility. As described in more detail in Item II.C. below, most of the commenters expressed overall support for the proposed approach.

The proposed rule change combines the proposals set forth in Regulatory Notices 09-70 and 15-20 with a few changes, including those made in response to comments.

#### Proposed Rules

##### A. Registration Requirements (Proposed FINRA Rule 1210)

NASD Rules 1021(a) and 1031(a) currently require that persons engaged, or to be engaged, in the investment banking or securities business of a member who are to function as representatives or principals register with FINRA in each category of registration appropriate to their functions as specified in NASD Rules 1022 and 1032.<sup>6</sup> FINRA is proposing to consolidate and streamline the provisions of NASD Rules 1021(a) and 1031(a) and adopt them as FINRA Rule 1210, subject to several changes.

Proposed FINRA Rule 1210 provides that each person engaged in the investment banking or securities business of a member must register with FINRA as a representative or principal in

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<sup>5</sup> FINRA is also evaluating the structure of the principal-level examinations and may propose to streamline this examination structure at a later time.

<sup>6</sup> In addition, NASD IM-1000-3 provides that the failure to register an individual as a registered representative may be deemed to be conduct inconsistent with just and equitable principles of trade and may be sufficient cause for appropriate disciplinary action.

each category of registration appropriate to his or her functions and responsibilities as specified in proposed FINRA Rule 1220, unless exempt from registration pursuant to proposed FINRA Rule 1230. Proposed FINRA Rule 1210 also provides that such person is not qualified to function in any registered capacity other than that for which the person is registered, unless otherwise stated in the rules. This latter provision is a consolidation of similar provisions in the registration categories under the current NASD rules.<sup>7</sup>

The original proposal in Regulatory Notice 09-70 created an “active” and “inactive” registration status in the CRD system to distinguish between required and permissive registrations, and it required firms to notify FINRA of such status. The proposed rule change eliminates the distinction between an “active” and “inactive” status.<sup>8</sup>

Further, FINRA is proposing to delete NASD IM-1000-3 because it is superfluous. The failure to register a representative as required under current NASD Rule 1031(a) is in fact a violation of FINRA rules.

B. Minimum Number of Registered Principals (Proposed FINRA Rule 1210.01)

NASD Rule 1021(e)(1) currently requires that a member, except a sole proprietorship, have a minimum of two registered principals with respect to each aspect of the member’s investment banking and securities business pursuant to the applicable provisions of NASD Rule 1022.<sup>9</sup> This requirement applies to applicants for membership and existing members.

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<sup>7</sup> See NASD Rules 1022(a)(6), (b)(3), (c)(4), (d)(2), (e)(3) and (f)(4) and NASD Rules 1032(b)(2), (c)(2), (d)(3), (e)(2), (f)(3), (g)(2), (h)(3) and (i)(4).

<sup>8</sup> However, as is the case under the current rules, FINRA will continue to use the term “inactive” in the CRD system in reference to persons who have failed to satisfy the Regulatory Element of the CE requirements, persons who have failed to submit their fingerprint information within the required time period and persons who are in active duty in the Armed Forces of the United States.

<sup>9</sup> In 2003, the rule was amended to replace the phrase “pursuant to the provisions of Rule 1022(a), (d) and (e), whichever are applicable” with the current phrase “pursuant to the

NASD Rule 1021(e)(2) provides that, pursuant to the FINRA Rule 9600 Series, FINRA may waive the two-principal requirement in situations that indicate conclusively that only one person associated with an applicant for membership should be required to register as a principal.

NASD Rule 1021(e)(3) provides that an applicant for membership, if the nature of its business so requires, must also have a Financial and Operations Principal (or an Introducing Broker-Dealer Financial and Operations Principal) and a Registered Options Principal.<sup>10</sup>

FINRA is proposing to adopt NASD Rule 1021(e) as FINRA Rule 1210.01, subject to the changes below. FINRA is proposing to provide firms that limit the scope of their business with greater flexibility to satisfy the two-principal requirement. In particular, proposed FINRA Rule 1210.01 requires that a member have a minimum of two General Securities Principals, provided that a member that is limited in the scope of its activities may instead have two officers or partners who are registered in a principal category that corresponds to the scope of the member's activities.<sup>11</sup> For instance, if a firm's business is limited to securities trading, the firm may opt to have two Securities Trader Principals, instead of two General Securities Principals.

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applicable provisions of Rule 1022.” See Securities Exchange Act Release No. 47433 (March 3, 2003), 68 FR 11424 (March 10, 2003) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change; File No. SR-NASD-2003-24). NASD Rules 1022(a), (d) and (e) are the registration categories of General Securities Principal, Investment Company and Variable Contracts Products Principal and Direct Participation Programs Principal, respectively. These principal registration categories, which depend on the scope of a firm's activities, are the only current principal categories that satisfy the two-principal requirement. The 2003 change was made for stylistic purposes and was part of other technical changes to the registration rules.

<sup>10</sup> NASD Rules 1022(b) and (c) require all firms to have a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal, as applicable. This requirement became effective on September 17, 2001. However, the requirement does not apply to members that were granted an exemption prior to September 17, 2001. See Notice to Members (“NTM”) 01-52 (August 2001).

<sup>11</sup> The principal registration categories are described in greater detail below.

Currently, a sole proprietor member (without any other associated persons) is not subject to the two-principal requirement because such member is operating as a one-person firm. Given that one-person firms may be organized in legal forms other than a sole proprietorship (such as a single-person limited liability company), proposed FINRA Rule 1210.01 provides that any member with only one associated person is excluded from the two-principal requirement.

In addition, proposed FINRA Rule 1210.01 clarifies that existing members as well as new applicants may request a waiver of the two-principal requirement.

The proposed rule further provides that all members are required to have a Financial and Operations Principal (or an Introducing Broker-Dealer Financial and Operations Principal, as applicable), a Principal Financial Officer and a Principal Operations Officer.<sup>12</sup> Moreover, the proposed rule requires that: (1) a member engaged in investment banking activities have an Investment Banking Principal;<sup>13</sup> (2) a member engaged in research activities have a Research Principal; (3) a member engaged in securities trading activities have a Securities Trader Principal; and (4) a member engaged in options activities with the public have a Registered Options Principal. These requirements extend to existing members as well as new applicants.

#### C. Permissive Registrations (Proposed FINRA Rule 1210.02)

NASD Rules 1021(a) and 1031(a) currently permit a member to register or maintain the registration(s) as a representative or principal of an individual performing legal, compliance,

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<sup>12</sup> Those members that are currently exempt from the requirement to have a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal based on an exemption granted to them prior to September 17, 2001 will continue to be exempt from this requirement. However, as noted below, such members will be subject to the requirement to designate a Principal Financial Officer and a Principal Operations Officer.

<sup>13</sup> As described below, the Investment Banking Principal registration category is a newly proposed principal category that corresponds to the registration requirements of current NASD Rule 1022(a)(1)(B).



internal audit, back-office operations<sup>14</sup> or similar responsibilities for the member. NASD Rule 1031(a) also permits a member to register or maintain the registration as a representative of an individual performing administrative support functions for registered persons. In addition, NASD Rules 1021(a) and 1031(a) permit a member to register or maintain the registration(s) as a representative or principal of an individual engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of the member.

FINRA is proposing to consolidate these provisions under FINRA Rule 1210.02. FINRA is also proposing to expand the scope of permissive registrations and clarify a member's obligations regarding individuals who are maintaining such registrations.<sup>15</sup>

Specifically, proposed FINRA Rule 1210.02 allows any associated person to obtain and maintain any registration permitted by the member.<sup>16</sup> For instance, an associated person of a member working solely in a clerical or ministerial capacity, such as in an administrative capacity, would be able to obtain and maintain a General Securities Representative registration with the member. As another example, an associated person of a member who is registered, and functioning solely, as a General Securities Representative would be able to obtain and maintain a General Securities Principal registration with the member. Further, proposed FINRA Rule 1210.02 allows an individual engaged in the investment banking or securities business of a

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<sup>14</sup> Back-office personnel that are functioning as Operations Professionals as set forth in FINRA Rule 1230(b)(6) are subject to the Operations Professional registration requirement.

<sup>15</sup> In 2007, FINRA filed with the SEC a similar proposed rule change. The proposed rule change was not published for comment in the Federal Register. See SR-FINRA-2007-004. FINRA withdrew SR-FINRA-2007-004 prior to filing this proposed rule change.

<sup>16</sup> In Regulatory Notice 09-70, FINRA referred to such individuals as associated person engaged in a bona fide business purpose of a member.

foreign securities affiliate or subsidiary of a member to obtain and maintain any registration permitted by the member.

FINRA is proposing to permit the registration of such individuals for several reasons. First, a member may foresee a need to move a former representative or principal who has not been registered for two or more years back into a position that would require such person to be registered. Currently, such persons are required to requalify (or obtain a waiver of the applicable qualification examinations) and reapply for registration. Second, the proposed rule change would allow members to develop a depth of associated persons with registrations in the event of unanticipated personnel changes. Third, allowing registration in additional categories encourages greater regulatory understanding. Finally, the proposed rule change would eliminate an inconsistency in the current rules, which permit some associated persons of a member to obtain permissive registrations, but not others who equally are engaged in the member's business.

Individuals maintaining a permissive registration under the proposed rule change would be considered registered persons and subject to all FINRA rules, to the extent relevant to their activities.<sup>17</sup> For instance, an individual working solely in an administrative capacity would be able to maintain a General Securities Representative registration and would be considered a registered person for purposes of FINRA Rule 3240 relating to borrowing from or lending to customers, but the rule would have no practical application to his or her conduct because he or she would not have any customers.

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<sup>17</sup> The original proposal included a subset of FINRA rules to which these individuals would be subject. FINRA believes that the revised approach, which is principle-based, provides firms the flexibility to tailor their supervisory systems to their business models and reduces the burden on FINRA of having to revise the subset of applicable rules each time FINRA adopts a new rule or amends an existing rule.

Consistent with the requirements of FINRA Rule 3110, members would be required to have adequate supervisory systems and procedures reasonably designed to ensure that individuals with permissive registrations do not act outside the scope of their assigned functions. With respect to an individual who solely maintains a permissive registration, such as an individual working exclusively in an administrative capacity, the individual's day-to-day supervisor may be a non-registered person. For purposes of compliance with FINRA Rule 3110(a)(5) (which requires the assignment of each registered person to an appropriately registered supervisor), members would be required to assign a registered supervisor to this person who would be responsible for periodically contacting such individual's day-to-day supervisor to verify that the individual is not acting outside the scope of his or her assigned functions. If such individual is permissively registered as a representative, the registered supervisor must be registered as a representative or principal. If the individual is permissively registered as a principal, the registered supervisor must be registered as a principal.<sup>18</sup>

FINRA is also considering enhancements to the CRD system and BrokerCheck, as part of a separate proposal, to identify whether a registered person is maintaining only a permissive registration and to disclose the significance of such permissive registration to the general public.

D. Qualification Examinations and Waivers of Examinations (Proposed FINRA Rule 1210.03)

NASD Rules 1021(a) and 1031(a) currently set forth general requirements that an individual pass an appropriate qualification examination before his or her registration as a

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<sup>18</sup> In either case, the registered supervisor of an individual who solely maintains a permissive registration would not be required to be registered in the same representative or principal registration category as the permissively-registered individual. For instance, for purposes of FINRA Rule 3110(a)(5), an Investment Company and Variable Contracts Products Principal would be able to function as the registered supervisor of an individual who is permissively maintaining a General Securities Principal registration.

representative or principal can become effective. Incorporated NYSE Rule 345.15(1)(a) includes a substantially similar requirement. FINRA is proposing to consolidate these provisions and adopt them as FINRA Rule 1210.03.

In addition, as noted above, FINRA is proposing to adopt a restructured representative-level qualification examination program whereby representative-level registrants would be required to take a general knowledge examination (the SIE) and a specialized knowledge examination<sup>19</sup> appropriate to their job functions at the firm with which they are associating. Therefore, proposed FINRA Rule 1210.03 provides that before the registration of a person as a representative can become effective under proposed FINRA Rule 1210, such person must pass the SIE and an appropriate representative-level qualification examination as specified in proposed FINRA Rule 1220.<sup>20</sup> Proposed FINRA Rule 1210.03 also provides that before the registration of a person as a principal can become effective under proposed FINRA Rule 1210, such person must pass an appropriate principal-level qualification examination as specified in proposed FINRA Rule 1220.

Further, proposed FINRA Rule 1210.03 provides that if a registered person's job functions change and he or she needs to become registered in another representative-level category, he or she would not need to pass the SIE again. Rather, the registered person would need to pass only the appropriate representative-level qualification examination.

Moreover, proposed FINRA Rule 1210.03 provides that all associated persons, such as associated persons whose functions are solely and exclusively clerical or ministerial, are eligible

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<sup>19</sup> The term "specialized" as used in the proposed rule change is only intended for discussion purposes to identify the proposed representative-level examinations and distinguish them from the current representative-level examinations. FINRA is not proposing to use the term "specialized" in the proposed rule text.

<sup>20</sup> Proposed FINRA Rule 1220 sets forth each registration category and applicable qualification examination.

to take the SIE. Proposed FINRA Rule 1210.03 also provides that individuals who are not associated persons of firms, such as members of the general public, are eligible to take the SIE. FINRA believes that expanding the pool of individuals who are eligible to take the SIE would enable prospective securities industry professionals to demonstrate to prospective employers a basic level of knowledge prior to submitting a job application. Further, this approach would allow for more flexibility and career mobility within the securities industry. While all associated persons of firms as well as individuals who are not associated persons would be eligible to take the SIE pursuant to proposed FINRA Rule 1210.03, passing the SIE alone would not qualify them for registration with FINRA. Rather, to be eligible for registration with FINRA, an individual must pass an applicable representative or principal qualification examination and complete the other requirements of the registration process.

The SIE would assess basic product knowledge; the structure and function of the securities industry markets, regulatory agencies and their functions; and regulated and prohibited practices. In particular, the SIE will cover four major areas. The first, “Knowledge of Capital Markets,” focuses on topics such as types of markets and offerings, broker-dealers and depositories, and economic cycles. The second, “Understanding Products and Their Risks,” covers securities products at a high level as well as associated investment risks. The third, “Understanding Trading, Customer Accounts and Prohibited Activities,” focuses on accounts, orders, settlement and prohibited activities. The final area, “Overview of the Regulatory Framework,” encompasses topics such as SROs, registration requirements and specified conduct rules. FINRA is anticipating that the SIE would include 75 scored questions plus an additional

10 unscored pretest questions.<sup>21</sup> The passing score would be determined through methodologies compliant with testing industry standards used to develop examinations and set passing standards.

The current FINRA representative-level examination program consists of 16 examinations (Series 6, 7, 11, 17, 22, 37, 38, 42, 57, 62, 72, 79, 82, 86, 87 and 99). As described in greater detail below, FINRA is proposing to eliminate the current registration categories of Order Processing Assistant Representative, United Kingdom Securities Representative, Canadian Securities Representative, Options Representative, Corporate Securities Representative and Government Securities Representative as well as the associated examinations, the Series 11, Series 17, Series 37, Series 38, Series 42, Series 62 and Series 72, respectively. In addition, FINRA is proposing to revise the remaining representative-level qualification examinations, which include the Series 6, Series 7, Series 22, Series 57, Series 79, Series 82, Series 86, Series 87 and Series 99, to develop specialized knowledge examinations.

FINRA is consulting with committees of industry subject matter experts to develop the content of the specialized knowledge examinations, which would exclude the content covered on the SIE. FINRA will file the SIE and the specialized knowledge examinations, including the content outlines for each examination, with the SEC separately.

The proposed rule change solely impacts the representative-level qualification requirements. The proposed rule change does not change the scope of the activities under the remaining representative categories. For instance, after the effective date of the proposed rule

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<sup>21</sup> Pretest questions are designed to ensure that new examination items meet acceptable testing standards prior to use for scoring purposes. Consistent with FINRA's current practice, the SIE would include 10 additional, unidentified pretest questions that do not contribute towards the individual's score. Therefore, the SIE actually would consist of 85 questions, 75 of which would be scored. The 10 pretest questions would be randomly distributed throughout the examination.

change, a previously unregistered individual registering as a Direct Participation Programs Representative for the first time would be required to pass the SIE and an appropriate specialized knowledge examination. However, such individual may engage only in those activities in which a current Direct Participation Programs Representative may engage under current NASD Rule 1032(c).

The table below illustrates the proposed changes to the representative-level examinations, including the anticipated number of questions<sup>22</sup> on each specialized knowledge examination, for those representative categories that would be retained under the proposed rule change.

<b>Registration Category (and CRD System Designation)</b>	<b>Current Examination(s)</b>	<b>Proposed Examination(s)</b>
Investment Company and Variable Contracts Products Representative (IR)	Series 6 (100 questions)	SIE (75 questions) + Specialized Series 6 (50 questions)
General Securities Representative (GS)	Series 7 (250 questions)	SIE (75 questions) + Specialized Series 7 (125 questions)
Direct Participation Programs Representative (DR)	Series 22 (100 questions)	SIE (75 questions) + Specialized Series 22 (50 questions)
Securities Trader (TD)	Series 57 (125 questions)	SIE (75 questions) + Specialized

<sup>22</sup> The specified number of questions for each specialized knowledge examination are [sic] estimates. The final number of questions on each examination may slightly vary based on additional work with the respective examination committees. Further, the table does not include the number of pretest questions on each of the listed examinations.

		Series 57 (50 questions)
Investment Banking Representative (IB)	Series 79 (175 questions)	SIE (75 questions) + Specialized Series 79 (75 questions)
Private Securities Offerings Representative (PR)	Series 82 (100 questions)	SIE (75 questions) + Specialized Series 82 (50 questions)
Research Analyst (RS)	Series 7 (250 questions) + Series 86 (Part I: Analysis) (100 questions) + Series 87 (Part II: Regulatory Administration and Best Practices) (50 questions)	SIE (75 questions) + Specialized Series 86 (Part I: Analysis) (100 questions) + Specialized Series 87 (Part II: Regulatory Administration and Best Practices) (50 questions)
Operations Professional (OS)	Series 99 (100 questions)	SIE (75 questions) + Specialized Series 99 (50 questions)

As noted in the table, FINRA is anticipating that the number of questions on each specialized knowledge examination would be equal to or shorter than the current qualification examination that it would replace. For example, the specialized Series 7 examination for General Securities Representatives would include 125 questions instead of the 250 questions on the current Series 7 examination, and the specialized Series 6 examination for Investment Company and Variable Contracts Products Representatives would include 50 questions instead of the 100 questions on the current Series 6 examination. However, the total number of questions on the SIE plus the applicable specialized knowledge examination could be fewer or greater than the number of questions on the current examinations.



As discussed below, FINRA is also proposing to eliminate the current prerequisite registration requirement for Research Analysts. An individual seeking registration as a Research Analyst would no longer be required to first register as a General Securities Representative as currently required. Instead, such individuals would need to pass the SIE and corresponding specialized knowledge examination for Research Analyst, which, as reflected in the table above, would decrease from 400 questions to 225 questions the total number of questions for individuals registering as Research Analysts.

Moreover, under the proposed rule change, individuals seeking registration in two or more representative-level categories would experience a net decrease in the total number of questions because the SIE content would be tested only once. For example, an individual who seeks registration as a General Securities Representative and an Investment Banking Representative today would take two examinations, the Series 7 and Series 79, totaling 425 questions. Under the proposed structure, an individual who seeks registration in the same categories would take the SIE, the specialized Series 7 examination and the specialized Series 79 examination, totaling 275 questions.

Individuals who are registered on the effective date of the proposed rule change would be eligible to maintain those registrations without being subject to any additional requirements. Individuals who had been registered within the past two years prior to the effective date of the proposed rule change would also be eligible to maintain those registrations without being subject to any additional requirements, provided that they re-register with FINRA within two years from the date of their last registration. Further, such individuals, with the exception of Order Processing Assistant Representatives and Foreign Associates, would be considered to have passed the SIE in the CRD system, and thus if they wish to register in any other representative

category after the effective date of the proposed rule change, they could do so by taking only the appropriate specialized knowledge examination.<sup>23</sup> However, with respect to an individual who is not registered on the effective date of the proposed rule change but was registered within the past two years prior to the effective date of the proposed rule change, the individual's SIE status in the CRD system would be administratively terminated if such individual does not register with FINRA within four years from the date of the individual's last registration.<sup>24</sup>

In addition, individuals, with the exception of Order Processing Assistant Representatives and Foreign Associates, who had been registered as representatives two or more years, but less than four years, prior to the effective date of the proposed rule change would also be considered to have passed the SIE and designated as such in the CRD system. Moreover, if such individuals re-register with a firm after the effective date of the proposed rule change and within four years of having been previously registered, they would only need to pass the specialized knowledge examination associated with that registration position. However, if they do not register with FINRA within four years from the date of their last registration, their SIE status in the CRD system would be administratively terminated.

Subject to Commission approval and the timing of such approval, FINRA intends to implement the revised structure in March 2018. Similar to the current process for registration, firms would continue to use the CRD system to request registrations for representatives. An

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<sup>23</sup> As noted above, FINRA is evaluating the structure of the principal-level examinations. Under the proposed rule change, only individuals who have passed an appropriate representative-level examination would be considered to have passed the SIE. Registered principals who do not hold an appropriate representative-level registration would not be considered to have passed the SIE. For example, an individual who is registered solely as a Financial and Operations Principal (Series 27) today would have to take the Series 7 to become registered as a General Securities Representative. Under the proposed rule change, in the future, this individual would have to pass the SIE and the specialized Series 7 examination to obtain registration as a General Securities Representative.

<sup>24</sup> As discussed below, FINRA is proposing a four-year expiration period for the SIE.

individual would be able to schedule both the SIE and specialized knowledge examinations for the same day, provided the individual is able to reserve space at one of FINRA's designated testing centers.

Further, FINRA is proposing to create an enrollment system separate from the CRD system to allow individuals who are not associated persons of a firm, including members of the general public, to enroll and pay the SIE examination fee. This system would also be available to associated persons of firms who are not required to be registered with FINRA. The enrollment system would provide individuals using the system with documentation (either in paper or electronic format) of a passing or failing result.

A firm would be able to obtain SIE results for associated persons who are registering as representatives through the CRD system. In addition, a firm would be able to view the passing status of an associated person who is not registering as a representative and an individual seeking to associate with the firm using an interface within the CRD system. The CRD system would also automatically obtain an individual's SIE results once a firm submits a Form U4 (Uniform Application for Securities Industry Registration or Transfer) and requests a registration for that individual.

FINRA is currently conducting a pricing analysis to determine a reasonable fee for the SIE and the specialized knowledge examinations. FINRA will file the examination fees with the SEC separately.

Finally, paragraph (d) of NASD Rule 1070 currently permits FINRA, in exceptional cases and where good cause is shown, to waive the applicable qualification examination and accept other standards as evidence of an applicant's qualifications for registration. The

Incorporated NYSE rules include substantially similar provisions.<sup>25</sup> FINRA is proposing to transfer the provisions of NASD Rule 1070(d) into proposed FINRA Rule 1210.03 with the following changes.<sup>26</sup> The proposed rule provides that FINRA will only consider examination waiver requests submitted by a firm for individuals associated with the firm who are seeking registration in a representative- or principal-level registration category. Moreover, proposed FINRA Rule 1210.03 states that FINRA will consider waivers of the SIE alone or the SIE and the representative- and principal-level examination(s) for such individuals. FINRA would not consider a waiver of the SIE for non-associated persons or for associated persons who are not registering as representatives or principals.

E. Requirements for Registered Persons Functioning as Principals for a Limited Period (Proposed FINRA Rule 1210.04)

NASD Rule 1021(d) provides that a person who is currently registered with a member as a representative and whose duties are changed by the member so as to require registration as a principal may function as a principal for up to 90 calendar days before he or she is required to pass the appropriate qualification examination for principal. In addition, it allows a formerly registered representative who is required to register as a principal to function as a principal without passing the appropriate principal qualification examination for up to 90 calendar days, provided the person first satisfies all applicable prerequisite requirements. A person who has never been registered does not qualify for this exception.

FINRA is proposing to adopt NASD Rule 1021(d) as FINRA Rule 1210.04, subject to the following changes. Proposed FINRA Rule 1210.04 states that a member may designate any

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<sup>25</sup> See Incorporated NYSE Rule 345.15(1)(b) and NYSE Rule Interpretation 345.15/01.

<sup>26</sup> NASD Rules 1070(a), (b) and (c) provide general information relating to the examination process. FINRA is proposing to delete these provisions given that they relate to the administration of the examination program rather than rule requirements.

person currently registered, or who becomes registered, with the member as a representative to function as a principal for a limited period, provided that such person has at least 18 months of experience functioning as a registered representative within the five-year period immediately preceding the designation. This change is intended to ensure that representatives designated to function as principals for the limited period under the proposed rule have an appropriate level of registered representative experience. The proposed rule clarifies that the requirements of the rule apply to designations to any principal category, including those categories that are not subject to a prerequisite representative-level registration requirement, such as the Financial and Operations Principal registration category.<sup>27</sup>

The proposed rule also clarifies that the individual must fulfill all applicable prerequisite registration, fee and examination requirements before his or her designation as a principal. Further, the proposed rule extends the limited period that such person may function as a principal before passing the applicable principal examination from 90 calendar days to 120 calendar days (because the current window in the CRD system for passing an examination is 120 calendar days). A person registered as an Order Processing Assistant Representative or a Foreign Associate would be prohibited from functioning as a principal for purposes of proposed FINRA Rule 1210.04 because of the very limited scope of his or her activities. The proposed rule also provides an exception to the experience requirement for principals who are designated by members to function in other principal categories for a limited period. Specifically, the proposed rule states that a member may designate any person currently registered, or who becomes

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<sup>27</sup> In this regard, FINRA notes that, as is currently the case, qualifying as a registered representative is a prerequisite to qualifying as a principal except with respect to the following principal-level registrations: (1) Compliance Official; (2) Supervisory Analyst; (3) Financial and Operations Principal; and (4) Introducing Broker-Dealer Financial and Operations Principal.

registered, with the member as a principal to function in another principal category for 120 calendar days before passing any applicable examinations. Finally, the proposed rule clarifies that members that lose their sole Registered Options Principal are subject to separate requirements set forth in proposed FINRA Rule 1220.03.

F. Rules of Conduct for Taking Examinations and Confidentiality of Examinations (Proposed FINRA Rule 1210.05)

Before taking an examination, FINRA currently requires each candidate to agree to the Rules of Conduct for taking a qualification examination. Among other things, the examination Rules of Conduct require each candidate to attest that he or she is in fact the person who is taking the examination. These Rules of Conduct also require that each candidate agree that the examination content is the intellectual property of FINRA and that the content cannot be copied or redistributed by any means. If FINRA discovers that a candidate has violated the Rules of Conduct for taking a qualification examination, the candidate may forfeit the results of the examination and may be subject to disciplinary action by FINRA. For instance, for cheating on a qualifications examination, FINRA's Sanction Guidelines recommend a bar.<sup>28</sup>

FINRA is proposing to codify the requirements relating to the Rules of Conduct for examinations under FINRA Rule 1210.05. FINRA is also proposing to adopt Rules of Conduct for taking the SIE for associated persons and non-associated persons who take the SIE. Specifically, proposed FINRA Rule 1210.05 states that associated persons taking the SIE would be subject to the SIE Rules of Conduct, and associated persons taking a representative or principal examination would be subject to the Rules of Conduct for representative and principal examinations. Pursuant to proposed FINRA Rule 1210.05, a violation of the SIE Rules of

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<sup>28</sup> See FINRA Sanction Guidelines at 40 (2013), [http://www.finra.org/sites/default/files/Sanctions\\_Guidelines.pdf](http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf).

Conduct or the Rules of Conduct for representative and principal examinations by an associated person would be deemed to be a violation of FINRA Rule 2010. Moreover, if FINRA determines that an associated person has violated the SIE Rules of Conduct or the Rules of Conduct for representative and principal examinations, the associated person may forfeit the results of the examination and may be subject to disciplinary action by FINRA.

Further, the proposed rule states that individuals taking the SIE who are not associated persons must agree to be subject to the SIE Rules of Conduct. Among other things, the SIE Rules of Conduct would require individuals to attest that they are not qualified to engage in the investment banking or securities business based on passing the SIE and would prohibit individuals from cheating on the examination or misrepresenting their qualifications to the public subsequent to passing the SIE. Moreover, non-associated persons may forfeit their SIE results and may be prohibited from retaking the SIE if FINRA determines that they cheated on the SIE or that they misrepresented their qualifications to the public subsequent to passing the SIE. In addition, if FINRA discovers that non-associated persons who have passed the SIE have subsequently engaged in other types of misconduct, FINRA would refer the matter to the appropriate authorities or regulators.

NASD Rule 1080 currently requires that qualification examinations content be kept confidential and addresses the disciplinary implications of violating the confidentiality provision.<sup>29</sup> FINRA is proposing to transfer the provisions of NASD Rule 1080 with non-substantive changes into proposed FINRA Rule 1210.05.

G. Waiting Periods for Retaking a Failed Examination (Proposed FINRA Rule 1210.06)

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<sup>29</sup> See also NYSE Information Memorandum 88-37 (November 1988).

NASD Rule 1070(e) currently sets forth waiting periods for retaking failed examinations.<sup>30</sup> The rule provides that a person who fails a qualification examination would be permitted to retake the examination after either a period of 30 calendar days has elapsed from the date of the prior examination or the next administration of an examination administered on a monthly basis. However, if the person fails an examination three or more times in succession, he or she would be prohibited from retaking the examination either until a period of 180 calendar days has elapsed from the date of his or her last attempt to pass the examination or until the sixth subsequent administration of an examination administered on a monthly basis. FINRA is proposing to adopt NASD Rule 1070(e) as FINRA Rule 1210.06, with the following changes.

Proposed FINRA Rule 1210.06 provides that a person who fails an examination may retake that examination after 30 calendar days from the date of the person's last attempt to pass that examination. The proposed rule deletes the reference to examinations administered on a monthly basis because examinations are no longer administered in such a manner.

Proposed FINRA Rule 1210.06 further provides that if a person fails an examination three or more times in succession within a two-year period, the person is prohibited from retaking that examination until 180 calendar days from the date of the person's last attempt to pass it. These waiting periods would apply to the SIE and the representative- and principal-level examinations. Moreover, the proposed rule provides that non-associated persons taking the SIE must agree to be subject to the same waiting periods for retaking the SIE.

#### H. CE Requirements (Proposed FINRA Rule 1210.07)

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<sup>30</sup> See also NYSE Information Memorandum 04-16 (March 2004).



Pursuant to FINRA Rule 1250,<sup>31</sup> the CE requirements applicable to registered persons consist of a Regulatory Element<sup>32</sup> and a Firm Element.<sup>33</sup> The Regulatory Element applies to registered persons and must be completed within prescribed time frames.<sup>34</sup> For purposes of the Regulatory Element, a “registered person” is defined as any person registered with FINRA as a representative, principal, assistant representative or research analyst.<sup>35</sup> 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. For purposes of the Firm Element, the term “covered registered persons” is defined as any registered person who has direct contact with customers in the conduct of the member’s securities sales, trading and investment banking activities, any person registered as an

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<sup>31</sup> As discussed below, FINRA is proposing to renumber FINRA Rule 1250 as FINRA Rule 1240 as part of this proposed rule change.

<sup>32</sup> See FINRA Rule 1250(a).

<sup>33</sup> See FINRA Rule 1250(b).

<sup>34</sup> Pursuant to FINRA Rule 1250(a), each specified registered person is required to complete the Regulatory Element initially within 120 days after the person’s second registration anniversary date and, thereafter, within 120 days after every third registration anniversary date. A registered person who has not completed the Regulatory Element program within the prescribed time frames will have his or her FINRA registrations deemed inactive and designated as “CE inactive” on the CRD system until such time as the requirements of the program have been satisfied. A CE inactive person is prohibited from performing, or being compensated for, any activities requiring registration, including supervision. See also NTM 95-35 (May 1995). Moreover, if a registered person is CE inactive for a two-year period, FINRA will administratively terminate the person’s registration status with FINRA. The two-year period would be calculated from the date the person becomes CE inactive. If a registered person becomes CE inactive but is not registered with a member when the two-year period ends, FINRA will nevertheless update the CRD system to reflect that the person did not satisfy the Regulatory Element program. In either case, such person must requalify (or obtain a waiver of the applicable qualification examination(s)) to be re-eligible for registration.

<sup>35</sup> See FINRA Rule 1250(a)(5).

Operations Professional pursuant to FINRA Rule 1230(b)(6) or as a Research Analyst pursuant to NASD Rule 1050, and the immediate supervisors of such persons.<sup>36</sup>

FINRA believes that all registered persons, regardless of their activities, should be subject to the Regulatory Element of the CE requirements so that they can keep their knowledge of the securities industry current. Therefore, FINRA is proposing to adopt FINRA Rule 1210.07 to clarify that all registered persons, including those who solely maintain a permissive registration, are required to satisfy the Regulatory Element, as specified in proposed FINRA Rule 1240. FINRA is making corresponding changes to proposed FINRA Rule 1240. FINRA is not proposing any changes to the Firm Element requirement at this time. Individuals who have passed the SIE but not a representative- or principal-level examination and do not hold a registered position would not be subject to any CE requirements.

Consistent with current practice, proposed FINRA Rule 1210.07 also provides that a registered person of a member who becomes CE inactive would not be permitted to be registered in another registration category with that member or be registered in any registration category with another member, until the person has satisfied the Regulatory Element.

#### I. Lapse of Registration and Expiration of SIE (Proposed FINRA Rule 1210.08)

NASD Rule 1021(c) currently states that any person whose registration has been revoked pursuant to FINRA Rule 8310 or whose most recent registration as a principal has been terminated for a period of two or more years immediately preceding the date of receipt by FINRA of a new application is required to pass a qualification examination for principals appropriate to the category of registration as specified in NASD Rule 1022. Pursuant to NASD Rule 1031(c), any person whose registration has been revoked pursuant to FINRA Rule 8310 or

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<sup>36</sup> See FINRA Rule 1250(b)(1).

whose most recent registration as a representative or principal has been terminated for a period of two or more years immediately preceding the date of receipt by FINRA of a new application is required to pass a qualification examination for representatives appropriate to the category of registration as specified in NASD Rule 1032.<sup>37</sup> The two years are calculated from the termination date stated on the individual's Form U5 (Uniform Termination Notice for Securities Industry Registration) and the date FINRA receives a new application for registration.

FINRA is proposing to consolidate the requirements of NASD Rules 1021(c) and 1031(c) and adopt them as FINRA Rule 1210.08. Proposed FINRA Rule 1210.08 clarifies that, for purposes of the proposed rule, an application would not be considered to have been received by FINRA if that application does not result in a registration.

Proposed FINRA Rule 1210.08 also sets forth the expiration period of the SIE. Based on the content covered on the SIE, FINRA is proposing that a passing result on the SIE be valid for four years. Therefore, under the proposed rule change, an individual who passes the SIE and is an associated person of a firm at the time would have up to four years from the date he or she passes the SIE to pass a representative-level examination to register as a representative with that firm, or a subsequent firm, without having to retake the SIE. In addition, an individual who passes the SIE and is not an associated person at the time would have up to four years from the date he or she passes the SIE to become an associated person of a firm and pass a representative-level examination and register as a representative without having to retake the SIE.

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<sup>37</sup> In addition, NASD Rule 1041(c) provides that if any person whose most recent registration as an Order Processing Assistant Representative has been terminated for a period of two or more years immediately preceding the date of receipt by FINRA of a new application is required to pass a qualification examination for Order Processing Assistant Representative. As discussed below, FINRA is proposing to eliminate NASD Rule 1041(c) as part of the elimination of the Order Processing Assistant Representative registration category.

Moreover, an individual holding a representative-level registration who leaves the industry after the effective date of the proposed rule change would have up to four years to reassociate with a firm and register as a representative without having to retake the SIE. However, the four-year expiration period in the proposed rule change extends only to the SIE, and not the representative- and principal-level registrations. The representative- and principal-level registrations would continue to be subject to a two-year expiration period as is the case today. However, in response to comments, FINRA will consider as part of a separate proposal the possibility of extending the two-year expiration period, provided that an individual can maintain specified levels of competence and knowledge of the industry and the related laws, rules and regulations through an alternative process, such as more frequent CE.

J. Waiver of Examinations for Individuals Working for a Financial Services Industry Affiliate of a Member (Proposed FINRA Rule 1210.09)

In Regulatory Notice 09-70, FINRA had proposed to adopt an RA status in the CRD system for individuals who would be working for a financial services industry affiliate of a member, and who would not be working in any capacity for the member. Specifically, the original proposal permitted a member to register or maintain the registration(s) as a representative or principal of any individual engaged in the business of a financial services industry affiliate of the member that controls, is controlled by or is under common control with the member. The proposal defined the term “financial services industry” as any industry regulated by the SEC, Commodity Futures Trading Commission (“CFTC”), state securities authorities, federal or state banking authorities, state insurance authorities, or substantially equivalent foreign regulatory authorities.

The original proposal required members to notify FINRA of an individual’s RA status and deemed an RA to have an inactive registration. Further, under the proposal, RAs were

considered registered persons, but were subject only to a subset of FINRA rules. The proposal also required a member to supervise adequately RAs so that they did not act on behalf of the member and complied with the subset of rules applicable to them. The proposal provided that an individual could remain in an RA status for 10 non-consecutive years, which were tolled if the individual was working for the member or was outside the financial services industry. In addition, the proposal provided that a statutorily disqualified individual was not eligible for an RA status, and forfeited his or her status as a result of such disqualification. Moreover, under the proposal, the failure to comply with any of the RA requirements resulted in a forfeiture of an individual's RA status altogether.

The purpose of the RA proposal was to provide a firm greater flexibility to move personnel, including senior and middle management, between the firm and its financial services affiliate(s) so that they could gain organizational skills and better knowledge of products developed by the affiliate(s) without the individuals having to requalify by examination each time they returned to the firm.<sup>38</sup>

Rather than allowing individuals to maintain their registrations based on an RA status, FINRA is proposing to adopt FINRA Rule 1210.09 to provide an alternative process whereby individuals who would be working for a financial services industry affiliate of a member<sup>39</sup> would terminate their registrations with the member and would be granted a waiver of their

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<sup>38</sup> As noted above, an individual must requalify by examination (or obtain a waiver of the applicable qualification examination(s)) if the individual re-registers with a firm two or more years after the individual's most recent registration as a representative or principal has been terminated.

<sup>39</sup> Proposed FINRA Rule 1210.09 defines a "financial services industry affiliate of a member" as a legal entity that controls, is controlled by or is under common control with a member and is regulated by the SEC, CFTC, state securities authorities, federal or state banking authorities, state insurance authorities, or substantially equivalent foreign regulatory authorities, which is similar to the definition in Regulatory Notice 09-70.

requelification requirements upon re-registering with a member, provided the firm that is requesting the waiver and the individual satisfy the criteria for a Financial Services Affiliate (“FSA”) waiver.

Under the proposed waiver process, the first time a registered person is designated as eligible for a waiver based on the FSA criteria, the member with which the individual is registered would notify FINRA of the FSA designation. The member would concurrently file a full Form U5 terminating the individual’s registration with the firm, which would also terminate the individual’s other SRO and state registrations. Further, BrokerCheck would reflect that the individual is no longer registered or associated with a member.

To be eligible for initial designation as an FSA-eligible person by a member, an individual must have been registered for a total of five years within the most recent 10-year period prior to the designation, including for the most recent year with that member. An individual would have to satisfy these preconditions only for purposes of his or her initial designation as an FSA-eligible person, and not for any subsequent FSA designation(s). Thereafter, the individual would be eligible for a waiver for up to seven years from the date of initial designation,<sup>40</sup> provided that the other conditions of the waiver, as described below, have been satisfied. Consequently, a member other than the member that initially designated an individual as an FSA-eligible person may request a waiver for the individual and more than one member may request a waiver for the individual during the seven-year period.<sup>41</sup>

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<sup>40</sup> Individuals would be eligible for a single, fixed seven-year period from the date of initial designation, and the period would not be tolled or renewed.

<sup>41</sup> The following examples illustrate this point:

Example 1. Firm A designates an individual as an FSA-eligible person by notifying FINRA and files a Form U5. The individual joins Firm A’s financial services affiliate. Firm A does not submit a waiver request for the individual. After working for Firm A’s financial services affiliate for three years, the individual directly joins Firm B’s financial

An individual designated as an FSA-eligible person would be subject to the Regulatory Element of CE while working for a financial services industry affiliate of a member. The individual would be subject to a Regulatory Element program that correlates to his or her most recent registration category, and CE would be based on the same cycle had the individual remained registered. If the individual fails to complete the prescribed Regulatory Element during the 120-day window for taking the session, he or she would lose FSA eligibility (i.e., the individual would have the standard two-year period after termination to re-register without having to retake an examination). FINRA is making corresponding changes to proposed FINRA Rule 1240.

Upon registering an FSA-eligible person, a firm would file a Form U4 and request the appropriate registration(s) for the individual. The firm would also submit an examination waiver request to FINRA,<sup>42</sup> similar to the process used today for waiver requests, and it would represent that the individual is eligible for an FSA waiver based on the conditions set forth below. FINRA

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services affiliate for three years. Firm B then submits a waiver request to register the individual.

Example 2. Same as Example 1, but the individual directly joins Firm B after working for Firm A's financial services affiliate, and Firm B submits a waiver request to register the individual at that point in time.

Example 3. Firm A designates an individual as an FSA-eligible person by notifying FINRA and files a Form U5. The individual joins Firm A's financial services affiliate for three years. Firm A then submits a waiver request to re-register the individual. After working for Firm A in a registered capacity for six months, Firm A re-designates the individual as an FSA-eligible person by notifying FINRA and files a Form U5. The individual rejoins Firm A's financial services affiliate for two years, after which the individual directly joins Firm B's financial services affiliate for one year. Firm B then submits a waiver request to register the individual.

Example 4. Same as Example 3, but the individual directly joins Firm B after the second period of working for Firm A's financial services affiliate, and Firm B submits a waiver request to register the individual at that point in time.

<sup>42</sup> FINRA would consider a waiver of the representative-level qualification examination(s), the principal-level qualification examination(s) and the SIE, as applicable.

would review the waiver request and make a determination of whether to grant the request within 30 calendar days of receiving the request. FINRA would summarily grant the request if the following conditions are met:

(1) Prior to the individual's initial designation as an FSA-eligible person, the individual was registered for a total of five years within the most recent 10-year period, including for the most recent year with the member that initially designated the individual as an FSA-eligible person;

(2) The waiver request is made within seven years of the individual's initial designation as an FSA-eligible person by a member;

(3) The initial designation and any subsequent designation(s) were made concurrently with the filing of the individual's related Form U5;

(4) The individual continuously worked for the financial services affiliate(s) of a member since the last Form U5 filing;

(5) The individual has complied with the Regulatory Element of CE; and

(6) The individual does not have any pending or adverse regulatory matters, or terminations, that are reportable on the Form U4, and has not otherwise been subject to a statutory disqualification while the individual was designated as an FSA-eligible person with a member.

Following the Form U5 filing, an individual could move between the financial services affiliates of a member so long as the individual is continuously working for an affiliate. Further, a member could submit multiple waiver requests for the individual, provided that the waiver



requests are made during the course of the seven-year period.<sup>43</sup> An individual who has been designated as an FSA-eligible person by a member would not be able to take additional examinations to gain additional registrations while working for a financial services affiliate of a member.

K. Status of Persons Serving in the Armed Forces of the United States (Proposed FINRA Rule 1210.10)

NASD IM-1000-2(a) and (b) and Incorporated NYSE Rule Interpretation 345(a)/03, which is substantially similar, currently provide specific relief to registered persons serving in the Armed Forces of the United States. Among other things, these rules permit a registered person of a member who volunteers for or is called into active duty in the Armed Forces of the United States to be registered in an inactive status and remain eligible to receive ongoing transaction-related compensation. NASD IM-1000-2(c) also includes specific provisions regarding the deferment of the lapse of registration requirements in NASD Rules 1021(c), 1031(c) and 1041(c) for formerly registered persons serving in the Armed Forces of the United States.

FINRA is proposing to adopt NASD IM-1000-2 as FINRA Rule 1210.10 with the following changes. To enhance the efficiency of the current notification process for registered persons serving in the Armed Forces, proposed FINRA Rule 1210.10 requires that the member with which such person is registered promptly notify FINRA of such person's return to employment with the member. A sole proprietor must similarly notify FINRA of his or her

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<sup>43</sup> For example, if a member submits a waiver request for an FSA-eligible person who has been working for a financial services affiliate of the member for three years and re-registers the individual, the member could subsequently file a Form U5 and re-designate the individual as an FSA-eligible person. Moreover, if the individual works with a financial services affiliate of the member for another three years, the member could submit a second waiver request and re-register the individual upon returning to the member.

return to participation in the investment banking or securities business. Further, proposed FINRA Rule 1210.10 provides that FINRA would also defer the lapse of the SIE for formerly registered persons serving in the Armed Forces of the United States.

L. Impermissible Registrations (Proposed FINRA Rule 1210.11)

NASD Rules 1021(a) and 1031(a) currently prohibit a member from maintaining a representative or principal registration with FINRA for any person who is no longer active in the member's investment banking or securities business, who is no longer functioning as a representative or principal as defined under the rules or where the sole purpose is to avoid the requalification requirement applicable to persons who have not been registered for two or more years. These rules also prohibit a member from applying for the registration of a person as representative or principal where the member does not intend to employ the person in its investment banking or securities business. These prohibitions do not apply to the current permissive registration categories.

In light of proposed FINRA Rule 1210.02, FINRA is proposing to delete these provisions and instead adopt FINRA Rule 1210.11 prohibiting a member from registering or maintaining the registration of a person unless the registration is consistent with the requirements of proposed FINRA Rule 1210.

M. Registration Categories (Proposed FINRA Rule 1220)

FINRA is proposing to integrate the various registration categories and related definitions under the NASD rules into a single rule, FINRA Rule 1220,<sup>44</sup> subject to the changes described below.

1. Definition of Principal (Proposed FINRA Rule 1220(a)(1))

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<sup>44</sup> FINRA is proposing to renumber FINRA Rule 1230 as FINRA Rule 1220 as part of the proposed rule change.

NASD Rule 1021(b) currently defines the term “principal” to include sole proprietors, officers, partners, managers of offices of supervisory jurisdiction and directors who are actively engaged in the management of the member’s investment banking or securities business, such as supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions. Incorporated NYSE Rule 311.17 defines the term “principal executive” to include associated persons designated to exercise senior principal executive responsibility over the various areas of the member’s business, such as operations, compliance, finances and credit, sales, underwriting, research and administration.<sup>45</sup>

FINRA believes that the definition of the term “principal” in NASD Rule 1021(b) generally captures principal executives as defined under Incorporated NYSE Rule 311.17. Thus, FINRA is proposing to streamline and adopt NASD Rule 1021(b) as FINRA Rule 1220(a)(1).

Proposed FINRA Rule 1220(a)(1) clarifies that a member’s chief executive officer (“CEO”) and chief financial officer (“CFO”) (or equivalent officers) are considered principals based solely on their status. The proposed rule further clarifies that the term “principal” includes any other associated person who is performing functions or carrying out responsibilities that are required to be performed or carried out by a principal under FINRA rules. In addition, the proposed rule codifies existing guidance by providing that the phrase “actively engaged in the management of the member’s investment banking or securities business” includes the management of, and the implementation of corporate policies related to, such business as well as managerial decision-making authority with respect to the member’s business and management-

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<sup>45</sup> Incorporated NYSE Rule Interpretation 311(b)(5)/01 requires that principal executives be appropriately qualified to perform their assigned functions.

level responsibilities for supervising any aspect of such business, such as serving as a voting member of the member's executive, management or operations committees.<sup>46</sup>

2. General Securities Principal (Proposed FINRA Rule 1220(a)(2))

NASD Rule 1022(a)(1) currently requires that an associated person who meets the definition of "principal" under NASD Rule 1021 register as a General Securities Principal. A person registering as a General Securities Principal must pass the General Securities Principal examination. The rule, however, provides that a principal is not required to register as a General Securities Principal if the person's activities are so limited as to qualify such person for one or more of the limited principal categories specified in NASD Rule 1022, such as a Financial and Operations Principal, an Introducing Broker-Dealer Financial and Operations Principal, a Registered Options Principal, an Investment Company and Variable Contracts Products Principal, a Direct Participation Programs Principal, a General Securities Sales Supervisor or a Government Securities Principal. Further, the rule does not preclude individuals registered in a limited principal category from registering as General Securities Principals.

NASD Rule 1022(a)(1) also requires that a member's CCO designated on Schedule A of the member's Form BD (Uniform Application for Broker-Dealer Registration) register as a General Securities Principal.<sup>47</sup> NASD Rule 1022(a)(1)(C) provides that if a member's activities are limited to investment company and variable contracts products, direct participation program securities or government securities, the member's CCO may instead register as an Investment Company and Variable Contracts Principal, a Direct Participation Programs Principal or a Government Securities Principal, respectively. In addition, for purposes of the CCO requirement for dual members, FINRA recognizes the NYSE Compliance Official examination as an

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<sup>46</sup> See NTM 99-49 (June 1999).

<sup>47</sup> See also FINRA Rule 3130(a).

acceptable alternative to the principal examination requirements for General Securities Principal, Investment Company and Variable Contracts Principal and Direct Participation Programs Principal, as applicable.<sup>48</sup> NASD Rule 1022(a)(1)(C) also includes transitioning and grandfathering provisions for CCOs.

NASD Rule 1022(a)(1)(A) provides that unless stated otherwise a person seeking to register as a General Securities Principal must satisfy the General Securities Representative or Corporate Securities Representative prerequisite registration. NASD Rule 1022(a)(2) qualifies this provision by providing that the Corporate Securities Representative prerequisite registration gives a General Securities Principal only limited supervisory authority.

NASD Rule 1022(a)(1)(B) requires that a General Securities Principal with responsibility over the investment banking activities specified in NASD Rule 1032(i) also satisfy the Investment Banking Representative registration requirement.

NASD Rule 1022(a)(3) includes a grandfathering provision for persons who were registered as principals before the adoption of the General Securities Principal registration category.

NASD Rule 1022(a)(4) provides that an associated person registered solely as a General Securities Principal is not qualified to function as a Financial and Operations Principal (or an Introducing Broker-Dealer Financial and Operations Principal, as applicable), Registered Options Principal, General Securities Sales Supervisor, Municipal Securities Principal or Municipal Fund Securities Limited Principal, unless the General Securities Principal is also registered in these other categories.

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<sup>48</sup> See NTM 01-51 (August 2001).

Pursuant to NASD Rule 1022(a)(5), a principal who is responsible for supervising the overall conduct of a Research Analyst or Supervisory Analyst engaged in equity research must be registered as a Research Principal.<sup>49</sup> In addition, existing rules and guidance provide that the content of a member's research reports on equity securities must be approved by a Research Principal or a Supervisory Analyst.<sup>50</sup> Existing guidance further provides that a General Securities Principal may review a member's research reports on equity securities for compliance with only the disclosure provisions of FINRA Rule 2241.<sup>51</sup>

NASD Rule 1022(a)(6) currently requires that each associated person who is included within the definition of "principal" in NASD Rule 1021 with supervisory responsibility over the securities trading activities described in NASD Rule 1032(f) register as a Securities Trader Principal. To qualify for registration as a Securities Trader Principal, an individual must be registered as a Securities Trader and pass the General Securities Principal qualification examination. The rule provides that a person qualified and registered as a Securities Trader Principal may only have supervisory responsibility over the activities specified in NASD Rule 1032(f), unless such person is separately registered in another appropriate principal registration category, such as the General Securities Principal registration category. The rule further provides that a person registered as a General Securities Principal is not qualified to supervise the trading activities described in NASD Rule 1032(f), unless he or she qualifies and registers as

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<sup>49</sup> See also NTM 04-81 (November 2004) and NTM 07-04 (January 2007) (collectively, "Research NTMs").

<sup>50</sup> See FINRA Rule 2210(b)(1)(B) and Research NTMs. Further, an exemption from NASD Rule 1050 for specified foreign analysts includes a condition that the content of a globally branded research report prepared by such foreign research analyst that is published or otherwise distributed by a member must be approved by a Research Principal or Supervisory Analyst. See NASD Rule 1050(f)(3)(A).

<sup>51</sup> See Research NTMs.

a Securities Trader (by passing the Series 57 examination) and affirmatively registers as a Securities Trader Principal.

FINRA is proposing to streamline the provisions of NASD Rule 1022(a) and adopt them as FINRA Rule 1220(a)(2) with the following changes.

FINRA is proposing to more clearly set forth the obligation to register as a General Securities Principal. Specifically, proposed FINRA Rule 1220(a)(2)(A) states that each principal as defined in proposed FINRA Rule 1220(a)(1) is required to register with FINRA as a General Securities Principal, subject to the following exceptions. The proposed rule provides that if a principal's activities include the functions of a Compliance Officer, a Financial and Operations Principal (or an Introducing Broker-Dealer Financial and Operations Principal, as applicable), a Principal Financial Officer, a Principal Operations Officer, an Investment Banking Principal, a Research Principal, a Securities Trader Principal or a Registered Options Principal, then the principal must appropriately register in one or more of these categories. Proposed FINRA Rule 1220(a)(2)(A) also provides that if a principal's activities are limited solely to the functions of a Government Securities Principal, an Investment Company and Variable Contracts Products Principal, a Direct Participation Programs Principal or a Private Securities Offerings Principal, then the principal may appropriately register in one or more of these categories in lieu of registering as a General Securities Principal.

Proposed FINRA Rule 1220(a)(2)(A) further provides that if a principal's activities are limited solely to the functions of a General Securities Sales Supervisor, then the principal may appropriately register in that category in lieu of registering as a General Securities Principal, provided that if the principal is engaged in options sales activities he or she must register as a General Securities Sales Supervisor or Registered Options Principal. In addition, proposed

FINRA Rule 1220(a)(2)(A) states that if a principal's activities are limited solely to the functions of a Supervisory Analyst, then the principal may appropriately register in that category in lieu of registering as a General Securities Principal, provided that if the principal is responsible for approving the content of a member's research report on equity securities, he or she must register as a Research Principal or Supervisory Analyst.

Proposed FINRA Rule 1220(a)(2)(B) requires that an individual registering as a General Securities Principal satisfy the General Securities Representative prerequisite registration and pass the General Securities Principal qualification examination. Proposed FINRA Rule 1220(a)(2)(B) also clarifies that an individual may register as a General Securities Sales Supervisor and pass the General Securities Principal Sales Supervisor Module qualification examination in lieu of passing the General Securities Principal examination.

In conjunction with the elimination of the Corporate Securities Representative registration category, FINRA is proposing to delete the provision in NASD Rule 1022(a)(1)(A) permitting the Corporate Securities Representative prerequisite registration. However, the proposed rule provides that, subject to the lapse of registration provisions in proposed FINRA Rule 1210.08, General Securities Principals who obtained the Corporate Securities Representative prerequisite registration in lieu of the General Securities Representative prerequisite registration and individuals who had been registered as such within the past two years prior to the effective date of the proposed rule change, may continue to supervise corporate securities activities as currently permitted.

Moreover, as described in greater detail below, FINRA is proposing to adopt with some changes the requirements of NASD Rule 1022(a)(1) relating to the registration of CCOs, NASD Rule 1022(a)(1)(B) relating to the supervision of investment banking activities, NASD Rule



1022(a)(5) relating to the supervision of research activities and NASD Rule 1022(a)(6) relating to the supervision of securities trading activities as FINRA Rules 1220(a)(3), (a)(5), (a)(6) and (a)(7), respectively.

FINRA is also proposing to eliminate the grandfathering provision for individuals who were registered as principals prior to the adoption of the General Securities Principal registration category because it no longer has any practical application. Finally, FINRA is proposing to delete the provision that persons eligible for registration in other principal categories are not precluded from registering as General Securities Principals because it is superfluous.

### 3. Compliance Officer (Proposed FINRA Rule 1220(a)(3))

FINRA is proposing to adopt NASD Rule 1022(a)(1)'s CCO registration requirement as FINRA Rule 1220(a)(3), subject to the following changes.

Specifically, proposed FINRA Rule 1220(a)(3) establishes a Compliance Officer registration category and requires all persons designated as CCOs on Schedule A of Form BD to register as Compliance Officers, subject to an exception for members engaged in limited investment banking or securities business. The proposed rule only addresses the registration requirements for CCOs. However, consistent with proposed FINRA Rule 1210.02 relating to permissive registrations, a firm may allow other associated persons to register as Compliance Officers.

FINRA had originally proposed to also adopt a Compliance Officer qualification examination for CCOs and other individuals registering as Compliance Officers. However, FINRA is proposing to maintain the existing qualification requirements pending its evaluation of the structure of the principal-level examinations. In addition, FINRA is proposing to provide CCOs of firms that engage in limited investment banking or securities business with greater

flexibility to satisfy the qualification requirements for CCOs. Specifically, proposed FINRA Rule 1220(a)(3) sets forth the following qualification requirements for Compliance Officer registration:

- Subject to the lapse of registration provisions in proposed FINRA Rule 1210.08, each person registered with FINRA as a General Securities Representative and a General Securities Principal on the effective date of the proposed rule change and each person who was registered with FINRA as a General Securities Representative and a General Securities Principal within two years prior to the effective date of the proposed rule change would be qualified to register as Compliance Officers without having to take any additional examinations. In addition, subject to the lapse of registration provisions in proposed FINRA Rule 1210.08, individuals registered as Compliance Officials in the CRD system on the effective date of the proposed rule change and individuals who were registered as such within two years prior to the effective date of the proposed rule change would also be qualified to register as Compliance Officers without having to take any additional examinations;<sup>52</sup>
- All other individuals registering as Compliance Officers after the effective date of the proposed rule change would have to: (1) satisfy the General Securities Representative prerequisite registration and pass the General Securities Principal qualification examination; or (2) pass the Compliance Official qualification examination.
- An individual designated as a CCO on Schedule A of Form BD of a member that is engaged in limited investment banking or securities business may be registered in a

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<sup>52</sup> FINRA notes that the proposed rule gives firms the option of registering Compliance Officials who are not designated as CCOs as Compliance Officers when the proposed rule becomes effective.

principal category under proposed FINRA Rule 1220(a) that corresponds to the limited scope of the member's business.

4. Financial and Operations Principal, Introducing Broker-Dealer Financial and Operations Principal, Principal Financial Officer and Principal Operations Officer (Proposed FINRA Rule 1220(a)(4))

NASD Rule 1022(b) currently provides that a principal who is responsible for the financial and operational management of a member that has a minimum net capital requirement of \$250,000 under SEA Rules 15c3-1(a)(1)(ii) and 15c3-1(a)(2)(i), or a member that has a minimum net capital requirement of \$150,000 under SEA Rule 15c3-1(a)(8), must be designated and registered as a Financial and Operations Principal. Such members also are required to designate a CFO who is required to be registered as a Financial and Operations Principal. In addition, NASD Rule 1022(c) currently provides that a principal who is responsible for the financial and operational management of a member that is subject to the net capital requirements of SEA Rule 15c3-1, other than a member that is subject to the net capital requirements of SEA Rules 15c3-1(a)(1)(ii), (a)(2)(i) or (a)(8), must be designated and registered as either a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal. Such members also are required to designate a CFO who is required to be registered as a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal. Financial and Operations Principals and Introducing Broker-Dealer Financial and Operations Principals are not subject to a prerequisite representative registration, but they must pass the Financial and Operations Principal or Introducing Broker-Dealer Financial and Operations Principal examination, as applicable.

Incorporated NYSE Rule Interpretations 311(b)(5)/02 and /03 require that dual members designate a CFO and a COO and that the CFO and the COO register as Financial and Operations

Principals if the member is a clearing firm, or as either Financial and Operations Principals or Introducing Broker-Dealer Financial and Operations Principals if the member is an introducing firm. If the member is an introducing firm, the same person may be designated as both the CFO and COO.

FINRA is proposing to merge the provisions in NASD Rules 1022(b) and 1022(c) regarding Financial and Operations Principals and Introducing Broker-Dealer Financial and Operations Principals and adopt them as FINRA Rule 1220(a)(4)(A). In addition, FINRA is proposing to revise the provisions in NASD Rules 1022(b) and (c) regarding the designation of CFOs and the provisions in Incorporated NYSE Rule Interpretations 311(b)(5)/02 and /03 regarding the designation of CFOs and COOs and adopt them as FINRA Rule 1220(a)(4)(B). FINRA does not believe it is necessary for an officer to have the title of CFO or COO for purposes of these provisions so long as the designated person performs the same functions. Therefore, proposed FINRA Rule 1220(a)(4)(B) requires members to instead designate: (1) a Principal Financial Officer with primary responsibility for financial filings and the related books and records; and (2) a Principal Operations Officer with primary responsibility for the day-to-day operations of the business, including overseeing the receipt and delivery of securities and funds, safeguarding customer and firm assets, calculation and collection of margin from customers and processing dividend receivables and payables and reorganization redemptions and those books and records related to such activities.

Consistent with the current qualification and registration requirements for CFOs and COOs, the proposed rule requires that a firm's Principal Financial Officer and Principal

Operations Officer qualify and register as Financial and Operations Principals or Introducing Broker-Dealer Financial and Operations Principals, as applicable.<sup>53</sup>

Because the financial and operational activities of members that neither self-clear nor provide clearing services are more limited, such members may designate the same person as the Principal Financial Officer, Principal Operations Officer and Financial and Operations Principal or Introducing Broker-Dealer Financial and Operations Principal (that is, such members are not required to designate different persons to function in these capacities).

Given the level of financial and operational responsibility at clearing and self-clearing members, FINRA believes that it is necessary for such members to designate separate persons to function as Principal Financial Officer and Principal Operations Officer. Such persons may also carry out the other responsibilities of a Financial and Operations Principal, such as supervision of individuals engaged in financial and operational activities. In addition, the proposed rule provides that a clearing or self-clearing member that is limited in size and resources may, pursuant to the FINRA Rule 9600 Series, request a waiver of the requirement to designate separate persons to function as Principal Financial Officer and Principal Operations Officer.

#### 5. Investment Banking Principal (Proposed FINRA Rule 1220(a)(5))

FINRA is proposing to adopt NASD Rule 1022(a)(1)(B) regarding the qualification and registration requirements for principals with responsibility over specified investment banking activities as FINRA Rule 1220(a)(5). To further facilitate the registration of such individuals, proposed FINRA Rule 1220(a)(5) establishes a registration category for Investment Banking Principal and requires that a principal responsible for supervising the investment banking

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<sup>53</sup> This requirement also applies to those members that are currently exempt from the requirement to have a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal. See NTM 01-52 (August 2001).

activities specified in proposed FINRA Rule 1220(b)(5) register as an Investment Banking Principal. The proposed rule provides that individuals registering as Investment Banking Principals must be registered as Investment Banking Representatives and pass the General Securities Principal qualification examination.

6. Research Principal (Proposed FINRA Rule 1220(a)(6))

FINRA is proposing to adopt NASD Rule 1022(a)(5) relating to the registration of Research Principals as FINRA Rule 1220(a)(6) with a few changes and clarifications.

First, proposed FINRA Rule 1220(a)(6) clarifies that a principal responsible for approving the content of a member's research reports on equity securities is required to register as a Research Principal, subject to the following exceptions: (1) a Supervisory Analyst may also approve the content of a member's research report on equity securities; and (2) a General Securities Principal may review a member's research report on equity securities only for compliance with the disclosure provisions of FINRA Rule 2241.

Second, the proposed rule clarifies that a Supervisory Analyst or General Securities Principal may approve the content of a member's research reports on debt securities<sup>54</sup> and the content of third-party research reports<sup>55</sup> in lieu of a Research Principal.

Third, the proposed rule modifies the examination requirements for Research Principals to require demonstrated competence in fundamental analysis and valuation of securities. By way of

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<sup>54</sup> The proposed rule change maintains the current requirements, which are set forth in other FINRA rules, allowing a Supervisory Analyst to approve the content of debt research reports. See FINRA Rules 2210(b)(1)(A) and (B) (stating that a Supervisory Analyst may approve the content of research reports on debt securities).

<sup>55</sup> See FINRA Rule 2241(h)(1) and Research NTMs.

background, Research Analysts are required to pass the Series 86 and Series 87 examinations.<sup>56</sup> The Analysis (Series 86) portion of the Research Analyst examination tests knowledge of fundamental analysis and valuation of equity securities and the Regulatory Administration and Best Practices (Series 87) portion of the Research Analyst examination tests knowledge of applicable rules and regulations pertaining to research. The qualification examination for Supervisory Analysts, the Series 16 examination, tests both knowledge of applicable rules and regulations and fundamental analysis and valuation. Currently, a Research Principal is required to be registered as a General Securities Principal and pass either the Series 87 examination or the Series 16 examination.<sup>57</sup> FINRA believes that a Research Principal would be able to carry out his or her supervisory responsibilities more effectively by having a level of knowledge of fundamental analysis and valuation commensurate with the research analysts whose content they approve. Thus, proposed FINRA Rule 1220(a)(6) requires that individuals registering as Research Principals after the effective date of the proposed rule change, register as either Research Analysts or Supervisory Analysts and pass the General Securities Principal qualification examination.

7. Securities Trader Principal (Proposed FINRA Rule 1220(a)(7))

FINRA is proposing to adopt NASD Rule 1022(a)(6) relating to Securities Trader Principal registration as FINRA Rule 1220(a)(7). Similar to the current rule, proposed FINRA Rule 1220(a)(7) requires that a principal responsible for supervising the securities trading activities specified in proposed FINRA Rule 1220(b)(4) register as a Securities Trader Principal.

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<sup>56</sup> Candidates are eligible for a waiver of the Series 86 examination, which tests knowledge of fundamental analysis and valuation of equity securities, if they have passed Levels I and II of the Chartered Financial Analyst (“CFA”) examination and meet other eligibility criteria.

<sup>57</sup> See Research NTMs.

The proposed rule requires that individuals registering as Securities Trader Principals must be registered as Securities Traders and pass the General Securities Principal qualification examination.

8. Registered Options Principal (Proposed FINRA Rules 1220(a)(8), .02 and .03)

NASD Rule 1022(f) currently requires that members engaged in options transactions with the public have at least one Registered Options Principal. A Registered Options Principal is required to satisfy the following prerequisite representative registration(s): (1) General Securities Representative; or (2) Options Representative and Corporate Securities Representative. An individual registering as a Registered Options Principal must also pass the Registered Options Principal examination. The rule includes additional requirements applicable to Registered Options Principals engaged in security futures activities.<sup>58</sup> NASD IM-1022-1 further requires that members that have one Registered Options Principal promptly notify FINRA and agree to specified conditions if such person is terminated, resigns, becomes incapacitated or is otherwise unable to perform his or her duties.

FINRA is proposing to adopt NASD Rule 1022(f) as FINRA Rule 1220(a)(8) with the following changes. Consistent with FINRA Rule 2360, which allows a General Securities Sales Supervisor (in addition to a Registered Options Principal) to approve accounts engaged in specified options activities, the proposed rule provides that a General Securities Sales Supervisor may also supervise options activities as specified in FINRA Rule 2360.

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<sup>58</sup> This provision provides that a Registered Options Principal who intends to engage in security futures activities must complete a Firm Element CE program that addresses security futures products before he or she can engage in such activities. There are similar provisions in NASD Rules 1022(g), 1032(a) and 1032(d).



Further, as discussed below, FINRA is proposing to eliminate the Options Representative and Corporate Securities Representative registration categories. In conjunction with these changes, FINRA is proposing to eliminate registration as an Options Representative and a Corporate Securities Representative from the prerequisite choices in the current rule. Consequently, a person registering as a Registered Options Principal under proposed FINRA Rule 1220(a)(8) would be required to satisfy the General Securities Representative prerequisite registration.

FINRA is proposing to consolidate and adopt the provisions regarding security futures activities in NASD Rules 1022(f), 1022(g), 1032(a) and 1032(d) with non-substantive changes as Supplementary Material .02 of FINRA Rule 1220. Finally, FINRA is proposing to adopt NASD IM-1022-1 with non-substantive changes as Supplementary Material .03 of FINRA Rule 1220.

#### 9. Government Securities Principal (Proposed FINRA Rule 1220(a)(9))

NASD Rule 1022(h) currently requires that associated persons functioning as principals with respect to members' government securities activities register as Government Securities Principals. Such persons are not subject to a principal qualification examination. However, a person registering as a Government Securities Principal is required to satisfy the General Securities Representative or Government Securities Representative prerequisite registration. Moreover, individuals registered as General Securities Principals who have the General Securities Representative or Government Securities Representative prerequisite registration are qualified to function as Government Securities Principals without having to register separately as such.

NASD Rule 1022(h) also includes a grandfathering provision for persons who were registered as principals before the 1988 adoption of the Government Securities Principal

registration category, and it provides that a firm must notify FINRA via the Form U4 when a person not previously registered with the firm as a principal assumes the duties of a Government Securities Principal. FINRA is proposing to adopt NASD Rule 1022(h) as FINRA Rule 1220(a)(9) with a few changes.

As noted below, FINRA is proposing to eliminate the Government Securities Representative registration category. In conjunction with this change, FINRA is proposing to eliminate registration as a Government Securities Representative from the prerequisite registration choices in the current rule. Consequently, a person registering as a Government Securities Principal under proposed FINRA Rule 1220(a)(9) would be required to satisfy the General Securities Representative prerequisite registration. Alternatively, proposed FINRA Rule 1220(a)(9) provides that individuals registered as General Securities Principals are qualified to function as Government Securities Principals without having to register separately under the proposed rule.

Proposed FINRA Rule 1220(a)(9) also eliminates the grandfathering provision in the current rule because it no longer has any practical application, and it eliminates the Form U4 notification requirement because it is redundant of other Form U4 requirements.<sup>59</sup>

10. General Securities Sales Supervisor (Proposed FINRA Rules 1220(a)(10) and 1220.04)

Pursuant to NASD Rule 1022(g), each associated person of a member who is included within the definition of “principal” in NASD Rule 1021 may register as a General Securities Sales Supervisor, instead of separately registering in multiple principal registration categories,<sup>60</sup>

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<sup>59</sup> See Article V, Section 2 of the FINRA By-Laws.

<sup>60</sup> For instance, a principal supervising the sale of corporate securities and options must be registered as a General Securities Principal and a Registered Options Principal, unless the principal is registered as a General Securities Sales Supervisor.

if the individual's supervisory responsibilities are limited solely to securities sales activities. A person registering as a General Securities Sales Supervisor must satisfy the General Securities Representative prerequisite registration and pass the General Securities Sales Supervisor examinations.<sup>61</sup> Moreover, a General Securities Sales Supervisor is precluded from performing any of the following activities: (1) supervision of the origination and structuring of underwritings; (2) supervision of market-making commitments; (3) supervision of the custody of firm or customer funds or securities for purposes of SEA Rule 15c3-3; or (4) supervision of overall compliance with financial responsibility rules. NASD IM-1022-2 explains the purpose of the General Securities Sales Supervisor registration category.

FINRA is proposing to adopt NASD Rule 1022(g) and NASD IM-1022-2 as FINRA Rule 1220(a)(10) and FINRA Rule 1220.04, respectively, with non-substantive changes.

11. Investment Company and Variable Contracts Products Principal and Direct Participation Programs Principal (Proposed FINRA Rules 1220(a)(11) and (a)(12))

Pursuant to NASD Rule 1022(d), each associated person of a member who is included within the definition of "principal" in NASD Rule 1021 may register as an Investment Company and Variable Contracts Products Principal, instead of registering as a General Securities Principal, if the individual's activities are limited solely to the solicitation, purchase or sale of redeemable securities of companies registered under the Investment Company Act of 1940 ("Investment Company Act"), securities of closed-end companies registered under the Investment Company Act during the period of original distribution and specified insurance contracts, such as variable contracts. A person registering as an Investment Company and Variable Contracts Products Principal must satisfy the General Securities Representative or

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<sup>61</sup> An individual may also register as a General Securities Sales Supervisor by passing a combination of other principal-level examinations.

Investment Company and Variable Contracts Products Representative prerequisite registration and pass the Investment Company and Variable Contracts Products Principal examination.

Pursuant to NASD Rule 1022(e), each associated person of a member who is included within the definition of “principal” in NASD Rule 1021 may register as a Direct Participation Programs Principal, instead of registering as a General Securities Principal, if the individual’s activities are limited solely to direct participation program securities.<sup>62</sup> A person registering as a Direct Participation Programs Principal must satisfy the General Securities Representative or Direct Participation Programs Representative prerequisite registration and pass the Direct Participation Programs Principal examination.

FINRA is proposing to adopt NASD Rules 1022(d) and (e) as FINRA Rules 1220(a)(11) and (a)(12), respectively, subject to the following changes. FINRA is proposing to eliminate the securities products listed under the Investment Company and Variable Contracts Products Principal registration category and instead list the products under the Investment Company and Variable Contracts Products Representative registration category. Specifically, proposed FINRA Rule 1220(a)(11) provides that a principal may register as an Investment Company and Variable Contracts Products Principal if his or her activities in the investment banking or securities business of a member are limited to the activities specified in proposed FINRA Rule 1220(b)(7). Similarly, FINRA is proposing to transfer the definition of “direct participation program” from the Direct Participation Programs Principal registration category to the Direct Participation

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<sup>62</sup> For purposes of the registration rules, a direct participation program is defined as a program that provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution, including, but not limited to, oil and gas programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof. Among other things, a real estate investment trust is excluded from the definition of a direct participation program. See NASD Rule 1022(e)(2).

Programs Representative registration category. Therefore, proposed FINRA Rule 1220(a)(12) provides that a principal may register as a Direct Participation Programs Principal if his or her activities in the investment banking or securities business of a member are limited to the activities specified in proposed FINRA Rule 1220(b)(8).

12. Private Securities Offerings Principal (Proposed FINRA Rule 1220(a)(13))

To provide firms with greater flexibility in designing their supervisory structure, FINRA is proposing to create a limited principal registration category under FINRA Rule 1220(a)(13) for principals whose activities are limited solely to the supervision of the private securities offerings specified in proposed FINRA Rule 1220(b)(9) (current NASD Rule 1032(h)). The proposed change is consistent with the limited registration categories for Investment Company and Variable Contracts Products Principals and Direct Participation Programs Principals. Specifically, under proposed FINRA Rule 1220(a)(13), if a principal's activities are limited solely to the supervision of the private securities activities specified in proposed FINRA Rule 1220(b)(9), the principal may register as a Private Securities Offerings Principal instead of registering as a General Securities Principal. A person registering as a Private Securities Offerings Principal must satisfy the Private Securities Offerings Representative prerequisite registration and pass the General Securities Principal examination.

13. Supervisory Analyst (Proposed FINRA Rule 1220(a)(14))

The Incorporated NYSE rules currently require that an individual who is responsible for approving research reports register as a Supervisory Analyst.<sup>63</sup> Such person is required to present evidence of appropriate experience (at least three years prior experience within the

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<sup>63</sup> See Incorporated NYSE Rules 344, 344.11 and 472(a)(2) and NYSE Rule Interpretations 344/03 and /04.

immediately preceding six years involving securities or financial analysis) and pass the Supervisory Analyst qualification examination. Rather than passing the entire Supervisory Analyst qualification examination, such person may obtain a waiver from the securities analysis portion (Part II) of the Supervisory Analyst qualification examination upon verification that the person has passed Level I of the CFA examination. Incorporated NYSE Rule 472(a)(2) further provides that where a Supervisory Analyst lacks technical expertise in a particular product area that is the subject of a research report, the content in the report may be co-approved by a product specialist; if no such expertise resides within the member, the rule requires the member to arrange approval by a qualified outside Supervisory Analyst.

As noted above, pursuant to FINRA rules and existing guidance, a Supervisory Analyst is permitted to approve the content of a member's research report on equity or debt securities. A Supervisory Analyst is also permitted to approve the content of third-party research reports. However, a Research Principal must supervise the overall conduct of a Supervisory Analyst engaged in equity research.

FINRA is proposing to adopt the provisions in Incorporated NYSE Rule 344 and NYSE Rule Interpretations 344/03 and /04 regarding Supervisory Analysts as FINRA Rule 1220(a)(14) with the following changes. Consistent with existing FINRA rules and guidance, proposed FINRA Rule 1220(a)(14) provides that a principal whose activities are limited to approving the content of a member's research reports on equity or debt securities or the content of third-party research reports has the option of registering as a Supervisory Analyst instead of registering as a Research Principal or General Securities Principal, as applicable. The proposed rule clarifies that a Supervisory Analyst engaged in equity research must be supervised by a Research Principal. In addition, consistent with FINRA Rule 2210(b)(1)(B), a Supervisory Analyst may

approve (1) retail communications as described in FINRA Rule 2241(a)(11)(A); and (2) other research communications that do not meet the definition of a “research report” under FINRA Rule 2241, provided that the Supervisory Analyst has technical expertise in the particular product area.

Unlike the NYSE requirements, proposed FINRA Rule 1220(a)(14) does not require evidence of appropriate experience. FINRA conducts job analysis activities for each examination program to identify the relevant rules and knowledge that need to be assessed. These activities involve subject matter experts from the industry as well as regulators and are conducted in compliance with testing industry standards for examination development. The resulting information is used to determine an appropriate content outline as well as to establish the appropriate way to assess the identified job, task and rule knowledge. In the case of the Supervisory Analyst examination, FINRA has determined that the requisite knowledge can be assessed adequately by the examination questions and that an experience requirement provides no material improvements to the qualification process. FINRA believes that passing the Supervisory Analyst qualification examination and completing the CE requirements adequately demonstrate the level of competence and knowledge required. This change is consistent with all other FINRA representative- and principal-level registration categories, which do not have an experience requirement. FINRA is also proposing to delete Incorporated NYSE Rule 472(a)(2), which requires that only Supervisory Analysts approve research reports. As described above, under FINRA rules, Supervisory Analysts are permitted to approve research reports, but they are not required to do so. For instance, a member may designate a Research Principal to approve its research reports.

14. Definition of Representative (Proposed FINRA Rule 1220(b)(1))

NASD Rule 1031(b) currently defines the term “representative” as an associated person, including an assistant officer other than a principal, who is engaged in the investment banking or securities business for the member, such as supervision, solicitation, conduct of business in securities or the training of persons associated with a member for any of these functions.

Incorporated NYSE Rule 10 defines the term “registered representative” as an employee of a member engaged in the solicitation or handling of accounts or orders for the purchase or sale of securities, or other similar instruments for the accounts of customers of his or her employer or in the solicitation or handling of business in connection with investment advisory or investment management services furnished on a fee basis by his or her employer.

FINRA believes that the definition of the term “representative” in NASD Rule 1031(b) is more consistent with the functions customarily performed by a registered representative. Therefore, FINRA is proposing to adopt NASD Rule 1031(b) as FINRA Rule 1220(b)(1) with non-substantive changes.

15. General Securities Representative (Proposed FINRA Rule 1220(b)(2))

NASD Rule 1032(a)(1) currently requires that an associated person who meets the definition of “representative” under NASD Rule 1031 register as a General Securities Representative. A person registering as a General Securities Representative must pass the General Securities Representative examination.<sup>64</sup> The rule, however, provides that a representative is not required to register as a General Securities Representative if the person’s activities are so limited as to qualify such person for one or more of the limited representative categories specified in NASD Rule 1032, such as an Investment Company and Variable

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<sup>64</sup> An individual may also register as a General Securities Representative by passing a combination of other representative-level examinations.



Contracts Products Representative, a Direct Participation Programs Representative, an Options Representative, a Corporate Securities Representative, a Securities Trader, a Government Securities Representative, a Private Securities Offerings Representative or an Investment Banking Representative. Further, the rule does not preclude individuals registered in a limited representative category from registering as General Securities Representatives.

NASD Rule 1032(a)(2) provides that if a representative does not engage in municipal securities activities, registration as a United Kingdom Securities Representative or Canada Securities Representative is equivalent to registration as a General Securities Representative. These foreign registration categories were created in the 1990s as an alternative to General Securities Representative registration for individuals who do not engage in municipal securities activities and who are in good standing as a representative with the Financial Conduct Authority in the United Kingdom or with a Canadian stock exchange or securities regulator. To qualify for registration as a United Kingdom Securities Representative or Canada Securities Representative, an individual must pass the United Kingdom Securities Representative examination or Canada Securities Representative examinations, respectively. NASD Rule 1032(a)(2) also permits a person registered and in good standing as a representative with the Japanese securities regulators to become qualified to function as a General Securities Representative by passing the Japan Module of the General Securities Representative examination. The Japan Module, however, was never implemented.

NASD Rule 1032(a)(3) provides that an associated person registered solely as a General Securities Representative is not qualified to function as a Registered Options Representative,

unless the General Securities Representative is separately qualified and registered as a Registered Options Representative.<sup>65</sup>

The Incorporated NYSE rules also require that a representative register as a General Securities Representative,<sup>66</sup> unless the representative's activities are so limited as to qualify him or her for one or more of the limited categories of representative registration, such as an Investment Company and Variable Contracts Products Representative or a Direct Participation Programs Representative.<sup>67</sup> The Incorporated NYSE rules further provide that registration as a United Kingdom Securities Representative or Canada Securities Representative is equivalent to registration as a General Securities Representative for those representatives who are not engaged in municipal securities activities.<sup>68</sup>

FINRA is proposing to streamline the provisions of NASD Rule 1032(a) and adopt them as FINRA Rule 1220(b)(2) with the following changes.

Similar to the proposed changes to the General Securities Principal registration category, FINRA is proposing to more clearly set forth the obligation to register as a General Securities Representative. Specifically, proposed FINRA Rule 1220(b)(2)(A) states that each representative as defined in proposed FINRA Rule 1220(b)(1) is required to register with FINRA

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<sup>65</sup> This provision was adopted in 1980 at a time when an associated person had to separately qualify and register as a Registered Options Representative. See Securities Exchange Act Release No. 16936 (June 26, 1980), 45 FR 45441 (July 3, 1980) (Order Approving Proposed Rule Change; File No. SR-NASD-80-1). In 1997, NASD Rule 1032(d) was amended to no longer require associated persons to separately qualify and register as Registered Options Representatives, but there was no corresponding change to NASD Rule 1032(a). See Securities Exchange Act Release No. 38969 (August 25, 1997), 62 FR 46535 (September 3, 1997) (Order Approving Proposed Rule Change; File No. SR-NASD-97-23).

<sup>66</sup> See Incorporated NYSE Rule 345.10 and .15(2) and NYSE Rule Interpretation 345.15/02.

<sup>67</sup> See Incorporated NYSE Rule 345.15(3) and NYSE Rule Interpretation 345.15/02.

<sup>68</sup> See NYSE Information Memoranda 91-09 (March 1991) and 96-06 (March 1996).

as a General Securities Representative, subject to the following exceptions. The proposed rule provides that if a representative's activities include the functions of an Operations Professional, a Securities Trader, an Investment Banking Representative or a Research Analyst, then the representative must appropriately register in one or more of these categories. Proposed FINRA Rule 1220(b)(2)(A) also provides that if a representative's activities are limited solely to the functions of an Investment Company and Variable Contracts Products Representative, a Direct Participation Programs Representative or a Private Securities Offerings Representative, then the representative may appropriately register in one or more of these categories in lieu of registering as a General Securities Representative.

Further, consistent with the proposed restructuring of the representative-level examinations, proposed FINRA Rule 1220(b)(2)(B) would require that individuals registering as General Securities Representatives pass the SIE and the General Securities Representative examination.

In addition, as part of the proposed restructuring of the representative-level examinations, FINRA is proposing to eliminate the United Kingdom Securities Representative and Canada Securities Representative registration categories, and associated Series 17, Series 37 and Series 38 examinations. Instead, FINRA is proposing to adopt FINRA Rule 1220.01 to provide individuals who are associated persons of firms and hold foreign registrations an alternative, more flexible, process to obtain a FINRA representative-level registration. Based on FINRA's analysis of the relevant United Kingdom and Canadian qualification requirements, FINRA believes that there is sufficient overlap between the SIE and these foreign qualification requirements to permit them to act as exemptions to the SIE. Under proposed FINRA Rule 1220.01, individuals who are in good standing as representatives with the Financial Conduct

Authority in the United Kingdom or with a Canadian stock exchange or securities regulator would be exempt from the requirement to pass the SIE, and thus would be required only to pass a specialized knowledge examination to register with FINRA as a representative. The proposed approach would provide individuals with a United Kingdom or Canadian qualification more flexibility to obtain a FINRA representative-level registration. For instance, an individual with the appropriate United Kingdom qualification who seeks registration as an Investment Banking Representative today would take the Series 79 examination, totaling 175 questions. Under the proposed rule change, the same individual would only take the specialized Series 79 examination, which FINRA is anticipating would have 75 questions.

FINRA is also proposing to delete the provision regarding the Japan Module of the General Securities Representative examination because it was never implemented. Further, FINRA is proposing to delete the provision restricting a General Securities Representative from functioning as a Registered Options Representative as a corresponding change to the 1997 amendment of NASD Rule 1032(d). Finally, FINRA is proposing to delete the provision that persons eligible for registration in other representative categories are not precluded from registering as General Securities Representatives because it is superfluous.

16. Operations Professional, Securities Trader, Investment Banking Representative, Research Analyst, Investment Company and Variable Contracts Products Representative, Direct Participation Programs Representative and Private Securities Offerings Representative (Proposed FINRA Rules 1220(b)(3), 1220(b)(4), 1220(b)(5), 1220(b)(6), 1220(b)(7), 1220(b)(8), 1220(b)(9) and 1220.05)

FINRA Rule 1230(b)(6) currently requires that specified persons who are engaged in, responsible for or supervising specified covered functions relating to operations register as Operations Professionals. The specified persons are: (1) senior management with direct responsibility over the covered functions; (2) any person designated by such senior management

as a supervisor, manager or other person responsible for approving or authorizing work in direct furtherance of the covered functions; and (3) persons with the authority or discretion materially to commit a firm's capital in direct furtherance of the covered functions or to commit a firm to any material contract or agreement in direct furtherance of the covered functions. Individuals registering as Operations Professionals must pass the Operations Professional examination, unless they hold an eligible registration, such as a General Securities Representative registration. In addition, FINRA Rule 1230(b)(6) includes specified time frames relating to the initial implementation of the rule and allows individuals to function as Operations Professionals for a limited period before having to pass an appropriate qualification examination. FINRA Rule 1230.06 provides that the determination of what constitutes "materially" or "material" in the third category of specified persons is based on a firm's pre-established spending guidelines and risk management policies. FINRA Rule 1230.06 also provides that any person whose activities are limited to performing a function ancillary to a covered function, or whose function is to serve a role that can be viewed as supportive of or advisory to the performance of a covered function, or who engages solely in clerical or ministerial activities in a covered function is not required to register as an Operations Professional. In addition, FINRA Rule 1230.06 provides an exception from the registration requirements for employees of a foreign broker-dealer who are engaged in specified limited activities.

Pursuant to NASD Rule 1032(f), each associated person of a member who is included within the definition of "representative" in NASD Rule 1031 is required to register as a Securities Trader if, with respect to transactions in equity (including equity options), preferred or convertible debt securities effected otherwise than on a securities exchange, such person is engaged in proprietary trading, the execution of transactions on an agency basis or the direct

supervision of such activities. The rule provides an exception from the registration requirement for any associated person of a member whose trading activities are conducted principally on behalf of an investment company that is registered with the SEC pursuant to the Investment Company Act and that controls, is controlled by, or is under common control with the member. The rule also requires that associated persons primarily responsible for the design, development or significant modification of algorithmic trading strategies (or responsible for the day-to-day supervision or direction of such activities) register as Securities Traders. Individuals registering as Securities Traders must pass the Securities Trader examination.

NASD Rule 1032(i) currently requires that each associated person of a member who is included within the definition of “representative” in NASD Rule 1031 and engaged in specified investment banking activities, such as advising on or facilitating debt or equity securities offerings through a private placement or a public offering, register as an Investment Banking Representative. Individuals registering as Investment Banking Representatives must pass the Investment Banking Representative examination. Individuals engaged in investment banking activities relating to direct participation program securities or private securities offerings as well as individuals engaged in retail or institutional sales and trading activities are not required to register as Investment Banking Representatives. In addition, the rule provides a limited exception from the requirements of the rule for individuals participating in a specified employee training program. NASD Rule 1032(i) also includes an opt-in provision, which allowed General Securities Representatives, Corporate Securities Representatives, United Kingdom Securities Representatives and Canada Securities Representatives who were engaged in investment banking activities covered by the rule to have opted in to the Investment Banking Representative registration category by May 3, 2010.

NASD Rule 1050 currently requires that an associated person whose primary job function is to provide investment research and who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report register as a Research Analyst.<sup>69</sup> NASD Rule 1050 provides that a person registering as a Research Analyst must satisfy the General Securities Representative prerequisite registration and pass the Research Analyst examinations. The purpose of the current prerequisite registration is to ensure that Research Analysts have general securities knowledge. There is a corresponding requirement under the Incorporated NYSE rules.<sup>70</sup>

Pursuant to NASD Rule 1032(b), each associated person of a member who is included within the definition of “representative” in NASD Rule 1031 may register as an Investment Company and Variable Contracts Products Representative, instead of registering as a General Securities Representative, if the individual’s activities are limited solely to redeemable securities of companies registered under the Investment Company Act, securities of closed-end companies registered under the Investment Company Act during the period of original distribution and specified insurance contracts, such as variable contracts. Individuals registering as Investment Company and Variable Contracts Products Representatives must pass the Investment Company and Variable Contracts Products Representative examination. Under NASD Rule 1032(c), each associated person of a member who is included within the definition of “representative” in NASD Rule 1031 may register as a Direct Participation Programs Representative, instead of

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<sup>69</sup> NASD Rule 1050 applies only to an associated person whose primary job function is to provide investment research and who is primarily responsible for the preparation of the substance of an equity research report or whose name appears on an equity research report. It does not currently apply to persons who produce debt research reports. See Research Rules Frequently Asked Questions, <http://www.finra.org/industry/faq-research-rules-frequently-asked-questions-faq>.

<sup>70</sup> See Incorporated NYSE Rules 344, 344.10 and 344.12 and NYSE Rule Interpretations 344/01 and /02.

registering as a General Securities Representative, if the individual's activities are limited solely to direct participation program securities. Individuals registering as Direct Participation Programs Representatives must pass the Direct Participation Programs Representative examination. The Incorporated NYSE rules include similar limited registration categories.<sup>71</sup>

Pursuant to NASD Rule 1032(h), each associated person of a member who is included within the definition of "representative" in NASD Rule 1031 may register as a Private Securities Offerings Representative, instead of registering as a General Securities Representative, if the individual's activities are limited solely to effecting sales of private placement securities, other than municipal, government or direct participation program securities, as part of a primary offering.<sup>72</sup> Individuals registering as Private Securities Offerings Representatives must pass the Private Securities Offerings Representative examination. NASD Rule 1032(h) includes a grandfathering provision that provides that any person who engaged in effecting sales of private securities offerings as an employee of a bank from May 12, 1999 to November 12, 1999, may register as a Private Securities Offerings Representative without having to pass the Private Securities Offerings Representative examination.

FINRA is proposing to adopt FINRA Rule 1230(b)(6), NASD Rule 1032(f), NASD Rule 1032(i), NASD Rule 1050, NASD Rule 1032(b), NASD Rule 1032(c) and NASD Rule 1032(h) with a few changes as FINRA Rules 1220(b)(3), (b)(4), (b)(5), (b)(6), (b)(7), (b)(8) and (b)(9), respectively. In addition, FINRA is proposing to adopt FINRA Rule 1230.06 as FINRA Rule 1220.05 with non-substantive changes.

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<sup>71</sup> See Incorporated NYSE Rule 345.15(3) and NYSE Rule Interpretation 345.15/02.

<sup>72</sup> Private Securities Offerings Representatives cannot effect resales of or secondary market transactions in private placement securities.



Specifically, consistent with the restructuring of the representative-level examinations, proposed FINRA Rules 1220(b)(3), (b)(4), (b)(5), (b)(6), (b)(7), (b)(8) and (b)(9) would require individuals registering in the respective registration categories to pass the SIE and the applicable representative-level examination(s). With respect to Research Analysts, given that general securities knowledge would be covered on the SIE, FINRA is proposing to replace the General Securities Representative prerequisite registration requirement with the SIE. Therefore, under proposed FINRA Rule 1220(b)(6), individuals registering as Research Analysts would be required to pass the SIE and the Research Analyst examinations. Consistent with existing guidance, FINRA is also proposing to clarify that the scope of FINRA Rule 1220(b)(6) is limited to equity research reports.

As noted above, FINRA is proposing to transfer the securities products listed under the Investment Company and Variable Contracts Products Principal registration category to the Investment Company and Variable Contracts Products Representative registration category. Further, consistent with the registration provisions of Municipal Securities Rulemaking Board (“MSRB”) Rule G-3(a), proposed FINRA Rule 1220(b)(7) clarifies that Investment Company and Variable Contracts Products Representatives are permitted to engage in the solicitation, purchase or sale of municipal fund securities as defined under MSRB Rule D-12. FINRA is also proposing to eliminate the opt-in provision in current NASD Rule 1032(i) and the time frames relating to the initial implementation of the Operations Professional registration category because these periods have passed.

#### 17. Eliminated Registration Categories (Proposed FINRA Rule 1220.06)

Pursuant to NASD Rule 1041, an associated person is not required to register as a General Securities Representative or in one or more of the limited categories of representative

registration if the person's activities are so limited as to qualify such person for registration as an Order Processing Assistant Representative. An Order Processing Assistant Representative is an associated person whose only function is to accept unsolicited customer orders (other than orders for municipal securities and direct participation program securities)<sup>73</sup> from existing customers for submission for execution by the member. Pursuant to NASD Rule 1042, Order Processing Assistant Representatives are subject to specified restrictions regarding their activities and compensation and are subject to particular supervisory requirements. In addition, they may not be registered concurrently in any other capacity.

NASD Rule 1032(d) currently provides that each associated person of a member who is included within the definition of "representative" in NASD Rule 1031 may register as an Options Representative, instead of a General Securities Representative, if the individual's activities are limited solely to options, including option contracts on government securities. Individuals registering as Options Representatives must satisfy the Corporate Securities Representative or Government Securities Representative prerequisite registration and pass the Options Representative examination. The Incorporated NYSE rules require that a "Registered Options Representative," a representative who transacts business with the public in option contracts, pass the General Securities Representative qualification examination.<sup>74</sup>

NASD Rule 1032(e) currently provides that each associated person of a member who is included within the definition of "representative" in NASD Rule 1031 may register as a Corporate Securities Representative, instead of a General Securities Representative, if the individual's activities are limited solely to securities as defined under Section 3(a)(10) of the

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<sup>73</sup> See NTM 89-78 (December 1989).

<sup>74</sup> See Incorporated NYSE Rules 345.10 and 345.15(4) and NYSE Rule Interpretation 345.15/02.

Act, other than municipal securities, options, mutual funds (except for money market funds), variable contracts and direct participation program securities. Individuals registering as Corporate Securities Representatives must pass the Corporate Securities Representative examination. NASD Rule 1032(g) provides that each associated person of a member who is included within the definition of “representative” in NASD Rule 1031 may register as a Government Securities Representative, instead of a General Securities Representative, if the individual’s activities are limited solely to government securities as defined in Sections 3(a)(42)(A) through (C) of the Act. Individuals registering as Government Securities Representatives must pass the Government Securities Representative examination.

Pursuant to NASD Rule 1100, associated persons registered as Foreign Associates<sup>75</sup> may function as registered representatives, including acting as traders or registered persons responsible for servicing the accounts of foreign nationals. However, they are exempt from the requirement to pass a qualification examination and are not subject to the Regulatory Element of CE requirements.

The Incorporated NYSE rules currently require that any person who has discretion to commit his or her employer member to any contract or agreement, written or oral, involving securities lending or borrowing activities and the direct supervisor of such person register as a

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<sup>75</sup> To qualify for registration as a Foreign Associate, an associated person: (1) cannot be a citizen, national, or resident of the United States or any of its territories or possessions; (2) must conduct all of his or her securities activities in areas outside the jurisdiction of the United States; and (3) cannot engage in any securities activities with or for any citizen, national or resident of the United States. To register an associated person as a Foreign Associate, a member must: (1) file a Form U4 with FINRA and certify that the person meets the criteria for a Foreign Associate; (2) attest that the person is not disqualified from registration; and (3) certify that service of process for any proceeding by FINRA for such person may be sent to an address designated by the member. If the Foreign Associate is terminated, the member must notify FINRA immediately by filing a Form U5.

Securities Lending Representative or Securities Lending Supervisor, as applicable.<sup>76</sup> Such individuals are also required to sign an agreement (representing a form of code of ethics) as an addendum to the Form U4. Such individuals are not required to pass a qualification examination, but they are required to complete the Regulatory Element of the CE requirements. NASD rules currently do not have a specific registration category for associated persons engaged in securities lending activities and in the direct supervision of such activities. Rather, securities lending is a covered function under the Operations Professional registration category.

FINRA is proposing to eliminate the current registration categories of Order Processing Assistant Representative, Options Representative, Corporate Securities Representative, Government Securities Representative and Foreign Associate.<sup>77</sup> FINRA believes that the utility of the Order Processing Assistant Representative registration category has diminished as technological advances and changes in industry practice have reduced the need for such representatives. As a result, the volume of candidates taking the Order Processing Assistant Representative examination has diminished and today less than 200 firms employ one or more Order Processing Assistant Representatives. The Options Representative, Corporate Securities Representative and Government Securities Representative registration categories were created over the years as subcategories of the General Securities Representative category. These subcategories currently allow an individual to sell a subset of the products (e.g., options, common stocks and corporate bonds, government securities) permitted to be sold by a General Securities Representative. In recent years, however, the utility of these subcategories has also diminished as a result of technological, regulatory and business practice changes. This is

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<sup>76</sup> See Incorporated NYSE Rules 345(a) and .10 and NYSE Rule Interpretation 345.15/02.

<sup>77</sup> As discussed above, FINRA is also proposing to eliminate the United Kingdom Securities Representative and Canada Securities Representative registration categories.

evidenced by the low annual volume for each of these examinations and the relatively low number of individuals who currently hold these registrations.

In addition, considering the type of interaction that Foreign Associates may have with customers, FINRA believes that such persons should demonstrate the same level of competence and knowledge required of their counterparts in the United States. Therefore, FINRA is proposing to eliminate this registration category.

Order Processing Assistant Representatives, United Kingdom Securities Representatives, Canada Securities Representatives, Options Representatives, Corporate Securities Representatives, Government Securities Representatives and Foreign Associates would be eligible to maintain their registrations with FINRA. Specifically, proposed FINRA Rule 1220.06 provides that, subject to the lapse of registration provisions in proposed FINRA Rule 1210.08, individuals who are registered as Order Processing Assistant Representatives, United Kingdom Securities Representatives, Canada Securities Representatives, Options Representatives, Corporate Securities Representatives or Government Securities Representatives on the effective date of the proposed rule change and individuals who had been registered in such categories within the past two years prior to the effective date of the proposed rule change would be eligible to maintain their registrations with FINRA. However, if individuals registered in these categories terminate their registration with FINRA and the registration remains terminated for two or more years, they would not be able to re-register in that category. With respect to Foreign Associates, proposed FINRA Rule 1220.06 provides that individuals registered as Foreign Associates on the effective date of the proposed rule change would also be eligible to maintain their registrations with FINRA. However, if Foreign Associates subsequently terminate their registrations with FINRA, they would not be able to re-register as Foreign Associates. Unlike

the other eliminated categories, Foreign Associates would not be eligible to re-register in the same category within two years of terminating their registrations because the two-year lapse of registration provision is only applicable to those registration categories that have an associated qualification examination. In addition, proposed FINRA Rule 1220.06 would include the current restrictions to which Order Processing Assistant Representatives are subject as well as the current conditions to which Foreign Associates are subject.

With respect to the NYSE registration categories for Securities Lending Representatives and Securities Lending Supervisors, FINRA had originally proposed to adopt these categories under a FINRA rule. However, given that securities lending activities are covered under the Operations Professional registration category, which is a more recent registration category, FINRA does not believe that it is necessary to adopt specific registration categories for individuals engaged in such activities. Moreover, FINRA is considering potential changes to the CRD system that would enable firms to identify registered persons engaged in securities lending activities through other functionalities.

#### 18. Grandfathering Provisions

In addition to the grandfathering provisions in proposed FINRA Rule 1220(a)(2) (relating to General Securities Principals), proposed FINRA Rule 1220(a)(3) (relating to Compliance Officers) and proposed FINRA Rule 1220.06 (relating to the eliminated registration categories), FINRA is proposing to include grandfathering provisions in proposed FINRA Rules 1220(a)(5), (a)(6), (a)(8), (a)(9), (a)(13), (b)(2), (b)(3), (b)(4), (b)(5), (b)(6), (b)(7), (b)(8) and (b)(9). Specifically, the proposed grandfathering provisions provide that, subject to the lapse of registration provisions in proposed FINRA Rule 1210.08, individuals who are registered with FINRA in specified registration categories on the effective date of the proposed rule change and

individuals who had been registered in such categories within the past two years prior to the effective date of the proposed rule change would be qualified to register in the proposed corresponding registration categories without having to take any additional examinations.

N. Associated Persons Exempt from Registration (Proposed FINRA Rules 1230 and 1230.01)

NASD Rule 1060(a) currently provides that the following associated persons are not required to register: (1) associated persons who are not actively engaged in the investment banking or securities business; (2) associated persons whose functions are related solely and exclusively to the member's need for nominal corporate officers or for capital participation; and (3) associated persons whose functions are related solely and exclusively to: effecting transactions on the floor of a national securities exchange and who are registered as floor members with such exchange, transactions in municipal securities, transactions in commodities or transactions in security futures (provided that any such person is registered with a registered futures association). In addition, both the NASD rules and the Incorporated NYSE rules provide an exemption from registration for associated persons whose functions are solely and exclusively clerical or ministerial.<sup>78</sup> NASD Rule 1060(a) is not meant to provide an exclusive or exhaustive list of exemptions from registration. Associated persons may otherwise be exempt from registration based on their activities and functions.

FINRA is proposing to adopt NASD Rule 1060(a) as FINRA Rule 1230 subject to the following changes. As noted above, NASD Rule 1060(a) exempts from registration those associated persons who are not actively engaged in the investment banking or securities business. NASD Rule 1060(a) also exempts from registration those associated persons whose functions are

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<sup>78</sup> See NASD Rule 1060(a)(1) and Incorporated NYSE Rule Interpretations 10/01 and 345(a)/01.

related solely and exclusively to a member's need for nominal corporate officers or for capital participation.<sup>79</sup> FINRA believes that the determination of whether an associated person is required to register must be based on an analysis of the person's activities and functions in the context of the various registration categories. FINRA does not believe that categorical exemptions for associated persons who are not "actively engaged" in a member's investment banking or securities business, associated persons whose functions are related only to a member's need for nominal corporate officers or associated persons whose functions are related only to a member's need for capital participation is consistent with this analytical framework. FINRA therefore is proposing to delete these exemptions. NASD Rule 1060(a) further exempts from registration associated persons whose functions are related solely and exclusively to effecting transactions on the floor of a national securities exchange as long as they are registered as floor members with such exchange. Because exchanges have registration categories other than the floor member category, proposed FINRA Rule 1230 clarifies that the exemption applies to associated persons solely and exclusively effecting transactions on the floor of a national securities exchange, provided they are appropriately registered with such exchange.

In NTM 87-47 (July 1987), FINRA stated that unregistered administrative personnel may occasionally receive an unsolicited customer order at a time when appropriately qualified representatives or principals are unavailable. FINRA believes that to accept customer orders a person must be appropriately registered. Accordingly, FINRA is proposing to rescind the guidance provided in NTM 87-47 and instead adopt FINRA Rule 1230.01 to clarify that the function of accepting customer orders is not considered a clerical or ministerial function and that

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<sup>79</sup> These exemptions generally apply to associated persons who are corporate officers of a member in name only to meet specific corporate legal obligations or who only provide capital for a member, but have no other role in a member's business.



associated persons who accept customer orders under any circumstances are required to be appropriately registered. However, the proposed rule provides that an associated person is not accepting a customer order where occasionally, when an appropriately registered person is unavailable, the associated person transcribes the order details and the registered person contacts the customer to confirm the order details before entering the order.

O. Changes to CE Requirements (Proposed FINRA Rule 1240)

As described above, FINRA Rule 1250 includes a Regulatory Element and a Firm Element. The Regulatory Element applies to registered persons and consists of periodic computer-based training on regulatory, compliance, ethical, supervisory subjects and sales practice standards. The Firm Element consists of at least annual, member-developed and administered training programs designed to keep covered registered persons current regarding securities products, services and strategies offered by the member. FINRA is proposing to renumber FINRA Rule 1250 as FINRA Rule 1240 with the changes discussed below.

1. Regulatory Element

FINRA is proposing to replace the term “registered person” under current FINRA Rule 1250(a) with the term “covered person” and make conforming changes to proposed FINRA Rule 1240(a). For purposes of the Regulatory Element, FINRA is proposing to define the term “covered person” under FINRA Rule 1240(a) as any person, other than a Foreign Associate, registered pursuant to proposed FINRA Rule 1210, including any person who is permissively registered pursuant to proposed FINRA Rule 1210.02, and any person who is designated as eligible for an FSA waiver pursuant to proposed FINRA Rule 1210.09. The purpose of this change is to ensure that all registered persons, including those with permissive registrations, keep their knowledge of the securities industry current. The inclusion of persons designated as

eligible for an FSA waiver under the term “covered persons” corresponds to the requirements of proposed FINRA Rule 1210.09. In addition, consistent with proposed FINRA Rule 1210.09, proposed FINRA Rule 1240(a) provides that an FSA-eligible person would be subject to a Regulatory Element program that correlates to his or her most recent registration category, and CE would be based on the same cycle had the individual remained registered. The proposed rule also provides that if an FSA-eligible person fails to complete the Regulatory Element during the prescribed time frames, he or she would lose FSA eligibility.

Further, FINRA is proposing to codify existing FINRA guidance regarding the impact of failing to complete the Regulatory Element on a registered person’s activities and compensation.<sup>80</sup> Specifically, proposed FINRA Rule 1240(a)(2) provides that any person whose registration has been deemed inactive under the rule may not accept or solicit business or receive any compensation for the purchase or sale of securities. The proposed rule provides, however, that such person may receive trail or residual commissions resulting from transactions completed before the inactive status, unless the member with which the person is associated has a policy prohibiting such trail or residual commissions.

FINRA is also proposing to remove superfluous language under current FINRA Rule 1250(a)(1) stating that FINRA shall determine the content of the Regulatory Element.

## 2. Firm Element

Current FINRA Rule 1250(b)(2)(B) provides that with respect to Research Analysts and their immediate supervisors, the minimum standards for the Firm Element training programs must cover training in ethics, professional responsibility and the requirements of FINRA Rule

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<sup>80</sup> See, e.g., NTM 95-35 (May 1995).

2241.<sup>81</sup> FINRA believes that training in ethics and professional responsibility should apply to all covered registered persons. Moreover, FINRA Rule 1250(a)(2)(A) currently requires that a member maintain a CE program that enhances a covered registered person’s professionalism. Therefore, proposed FINRA Rule 1240(b)(2)(B) requires that a firm’s training program cover training in ethics and professional responsibility. FINRA is also proposing to eliminate the specific requirement that Research Analysts receive training regarding FINRA Rule 2241. FINRA believes that this requirement is already addressed under current FINRA Rule 1250(b)(2)(B), which provides that the Firm Element training programs must cover applicable regulatory requirements.

P. Deletion of Incorporated NYSE Rules

FINRA is proposing to delete the following Incorporated NYSE rules as they are substantially similar to the proposed consolidated registration rules, otherwise incorporated as described above, rendered obsolete by the proposed approach reflected in the consolidated registration rules, or addressed by other rules:

- Incorporated NYSE Rule 10 (definition of “registered representative”);
- Incorporated NYSE Rule Interpretations 10/01 and 345(a)/01 (clerical and ministerial exemption from registration);
- Incorporated NYSE Rule 311.17 (definition of “principal executive”);
- Incorporated NYSE Rule Interpretation 311(b)(5)/01 (qualification requirements for principal executives);
- Incorporated NYSE Rule Interpretations 311(b)(5)/02 and /03 (relating to the designation and registration of a CFO and a COO);

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<sup>81</sup> See FINRA Rule 1250(b)(2)(B)(iv).

- Incorporated NYSE Rule Interpretation 311(g)/01 (requirement that members carrying customer accounts have at least two general partners);<sup>82</sup>
- Incorporated NYSE Rule 321.15 (registration of specified employees of a foreign subsidiary);
- Incorporated NYSE Rule 344 and its Interpretation (Research Analyst and Supervisory Analyst registration categories);
- Incorporated NYSE Rules 345(a), 345.10, 345.15(2) through 345.15(4) and NYSE Rule Interpretation 345.15/02 (representative categories);<sup>83</sup>
- Incorporated NYSE Rules 345.12, 345.13, 345.17 and 345.18 and NYSE Rule Interpretations 345.12/01 and 345.18/01 (Forms U4 and U5 filing requirements);
- Incorporated NYSE Rule 345.15(1)(a) (examination requirement);
- Incorporated NYSE Rule 345.15(1)(b) and NYSE Rule Interpretation 345.15/01 (examination waivers);
- Incorporated NYSE Rule Interpretation 345(a)/02 (independent contractor status);<sup>84</sup>

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<sup>82</sup> This is a conforming change. The corresponding rule incorporated from the NYSE, Incorporated NYSE Rule 311(h), was deleted as part of a prior proposed rule change. See Securities Exchange Act Release No. 58533 (September 12, 2008), 73 FR 54652 (September 22, 2008) (Order Approving Proposed Rule Change; File No. SR-FINRA-2008-036).

<sup>83</sup> FINRA is also proposing to delete the NYSE registration requirements relating to commodities solicitors (Incorporated NYSE Rule 345.15(5) (Commodities Solicitors)) and floor members and floor clerks (Incorporated NYSE Rule Interpretation 345.15/02) as these activities are not within the scope of the proposed FINRA registration rules.

<sup>84</sup> Incorporated NYSE Rule Interpretation 345(a)/02 provides that an independent contractor is deemed an employee of a member for purposes of the NYSE rules and requires that the member comply with specified requirements when entering into an arrangement with any person asserting independent contractor status, including a requirement that the independent contractor execute a “consent to jurisdiction” form. The status of independent contractors as associated persons of a member under FINRA rules is well settled. See, e.g., Letter from Douglas Scarff, Director, Division of Market Regulation, SEC, to Gordon S. Macklin, President, NASD (June 18, 1982).

- Incorporated NYSE Rule Interpretation 345(a)/03 (status of persons serving in the Armed Forces);
- Incorporated NYSE Rule Interpretation 345(b) (provisions regarding officers);<sup>85</sup>
- Incorporated NYSE Rule 345.16 (requirement to provide information regarding members' employees); and
- Incorporated NYSE Rule 472(a)(2) (requiring research reports to be approved by a Supervisory Analyst).

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The effective date will be no later than 18 months 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,<sup>86</sup> 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, and Section 15A(g)(3) of the Act,<sup>87</sup> which authorizes FINRA to prescribe standards of training, experience and competence for persons associated with FINRA members.

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<sup>85</sup> This is a conforming change. The corresponding NYSE rule, NYSE Rule 345(b), was deleted as part of a prior proposed rule change. See Securities Exchange Act Release No. 58533 (September 12, 2008), 73 FR 54652 (September 22, 2008) (Order Approving Proposed Rule Change; File No. SR-FINRA-2008-036).

<sup>86</sup> 15 U.S.C. 78o-3(b)(6).

<sup>87</sup> 15 U.S.C. 78o-3(g)(3).

FINRA believes that the proposed rule change will streamline, and bring consistency and uniformity to, the registration rules, which will, in turn, assist members and their associated persons in complying with these rules and improve regulatory efficiency. The proposed rule change will also improve the efficiency of the examination program, without compromising the qualification standards, by eliminating duplicative testing of general securities knowledge on examinations and by removing examinations that currently have limited utility.

In addition, the proposed rule change will expand the scope of permissive registrations, which, among other things, will allow members to develop a depth of associated persons with registrations to respond to unanticipated personnel changes and will encourage greater regulatory understanding. Further, the proposed rule change will provide a more streamlined and effective waiver process for individuals working for a financial services industry affiliate of a member, and it will require such individuals to maintain specified levels of competence and knowledge while working in areas ancillary to the investment banking and securities business.

The proposed rule change will improve the supervisory structure of firms by imposing an experience requirement for representatives that are designated by firms to function as principals for a 120-day period before having to pass an appropriate principal qualification examination. The proposed rule change will also prohibit unregistered persons from accepting customer orders under any circumstances, which will enhance investor protection.

Finally, FINRA believes that, with the introduction of the SIE and expansion of the pool of individuals who are eligible to take the SIE, the proposed rule change has the potential of enhancing the pool of prospective securities industry professionals by introducing them to securities laws, rules and regulations and appropriate conduct before they join the industry in a registered capacity.

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.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the need for the proposed rulemaking, the regulatory objective of the rulemaking, the economic baseline of analysis, the economic impacts and the alternatives considered.

1. Need for the Rules

The Act authorizes FINRA to prescribe standards of training, experience, and competence for persons associated with FINRA members. In accordance with that provision, FINRA has adopted registration requirements and developed qualification examinations that are designed to establish that persons associated with FINRA members have attained specified levels of competence and knowledge consistent with the applicable registration requirements.

As part of the process of developing the Consolidated FINRA Rulebook, FINRA undertook a review of the NASD registration rules and the Incorporated NYSE rules relating to registration to streamline and update the rules and eliminate duplicative, obsolete or superfluous provisions. The proposed consolidated registration rules are the result of that process.

FINRA also reviewed its representative-level examination program and determined to enhance the overall efficiency of the program by eliminating redundancy of subject matter content across examinations, retiring several outdated representative-level registrations and introducing a general knowledge examination that could be taken by all potential representative-level registrants and the general public.

2. Regulatory Objectives

The proposed rule change would create a more effective and efficient qualification and registration process, without impacting the proficiency required to function as a representative or principal or reducing investor protection. In addition, the proposed rule change has the potential of enhancing the pool of prospective securities industry professionals by familiarizing them with securities laws, rules and regulations and appropriate conduct at an earlier stage of career development.

### 3. Economic Baseline

The baseline for the economic impact assessment is the current structure of the registration rules and the examination program. As of October 2016, there were approximately 500,000 individuals holding representative level registrations and approximately 140,000 individuals holding principal level registrations (approximately 640,000 individuals total).<sup>88</sup>

The NASD rules relating to qualification and registration are a complex framework, which can result in compliance and operational challenges for firms. Moreover, dual members of FINRA and the NYSE are required to comply with the NASD rules and the Incorporated NYSE rules. As set forth in Regulatory Notice 09-70, the NASD and Incorporated NYSE rules include differences regarding the respective qualification and registration requirements, which create further compliance and operational challenges for dual members.

The qualification examination program sets basic standards of competency for persons associated with FINRA members, and fosters compliance with FINRA rules through required examinations and continuing education. The examinations collectively cover a broad range of

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<sup>88</sup> The numbers provided in this economic impact assessment are rounded to reasonable approximations for ease of reference.



subjects on the markets, the securities industry and its regulatory structure. The content includes knowledge of FINRA rules as well as the rules of the SEC and other SROs.

FINRA notes that in 2015, there were more than 90,000 exam candidates in 16 representative-level examinations. The Series 6, 7 and 79 examinations were the three examinations with the highest volume in terms of candidates, constituting more than 90% of the total candidate volume. The examinations that are proposed to be eliminated (Series 11, 17, 37, 38, 42, 62 and 72) constitute less than 1% of the total candidate volume in 2015.

There is considerable overlap in the general securities knowledge content of the current representative-level examinations, which results in duplicative testing of such content for individuals who are required to pass multiple examinations.

In addition, individuals generally must be associated with a member to be eligible to take a qualification examination, which, among other things, hinders the development of a pool of prospective securities industry professionals. In the absence of the proposed rule change, firms, associated persons and other impacted persons would continue to be subject to the complexities, challenges and inefficiencies of the current structure.

#### 4. Economic Impacts

FINRA notes that the proposed rule change includes a variety of changes, some of which may have a more significant impact. The following analysis will focus on those changes that are anticipated to have a material impact.

##### A. Minimum Number of Registered Principals (Proposed FINRA Rule 1210.01)

The proposed rule provides firms with greater flexibility to satisfy the two-principal requirement, as members can choose a principal registration category that better matches with the scope of the member's activities. For example, if a firm's activities are focused solely on

investment banking, it may choose to have two Investment Banking Principals, instead of two General Securities Principals. This flexibility should benefit members that specialize in a single security or market or otherwise engage in more limited activities.

**B. Permissive Registrations (Proposed FINRA Rule 1210.02)**

The proposed rule expands the scope of permissive registrations by allowing any associated person to obtain and maintain any registration permitted by the member. The proposed rule is expected to facilitate movement of registered personnel within and across firms and help firms better manage unanticipated needs for registered personnel by allowing them to maintain a roster of permissively registered persons available to meet those needs. The ability to permissively register associated persons may benefit such individuals and their firms by creating savings in examination fees, examination preparation time and time spent in the examination centers.

However, members that choose to permissively register associated persons would incur the cost of complying with the requirements of the proposed rule, including the cost of establishing adequate supervisory systems and procedures reasonably designed to ensure that such individuals do not act outside the scope of their assigned functions. FINRA believes that the proposed requirements are necessary to protect against the potential misuse of permissive registrations and any attendant costs are only borne at the discretion of the firm.

**C. Qualification Examinations and Waivers of Examinations (Proposed FINRA Rule 1210.03)**

The proposed rule adopts a restructured representative-level qualification examination program whereby representative-level registrants would be required to take a general knowledge examination (the SIE) and a specialized knowledge examination. As noted above, FINRA is currently conducting a pricing analysis to determine a reasonable fee for the SIE and the

specialized knowledge examinations. FINRA will file a separate proposed rule change to establish the fees for the SIE and the specialized knowledge examinations, which will include a pricing analysis. The focus of the economic impact assessment in this proposed rule change, therefore, is on the anticipated number of future candidates and the total number of examination questions that they would be required to answer as a proxy for the effort required to complete a qualification examination.

As described in greater detail below, while some individuals would see an increase in examination questions, FINRA is anticipating that more than half of the individuals seeking a representative-level registration would see a reduction in the number of examination questions.

Under the proposed rule, individuals seeking representative-level registrations must prepare and sit for the SIE and a separate specialized knowledge examination instead of prepare and sit for a single examination that covers both general and specialized knowledge of the securities industry as currently required. Some of these individuals would experience a net decrease in their total number of examination questions, and some would experience a net increase.

Specifically, individuals seeking the General Securities Representative, Investment Banking Representative or Research Analyst registration would experience a net decrease in their total number of examination questions under the proposal.<sup>89</sup> This accounts for approximately 54% of individuals seeking registration for the first time or after a lapse in registration of four or more years.<sup>90</sup> Individuals seeking registration in other limited

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<sup>89</sup> Individuals seeking registration as Research Analysts will experience a net decrease in the number of questions because such individuals would no longer be required to first register as General Securities Representatives.

<sup>90</sup> The reported percentages are calculated from estimated volumes based on five-year averages for all examinations except the Operations Professional examination (Series 99).

representative categories, including the Investment Company and Variable Contracts Products Representative, Direct Participation Programs Representative, Private Securities Offerings Representative or Operations Professional category, would experience a net increase in their total number of examination questions under the proposed rule. This accounts for approximately 44% of individuals seeking registration for the first time or after a lapse in registration of four or more years. In 2015, approximately 75,000 individuals took at least one of the 16 representative-level examinations. Approximately 8% of these candidates took two or more distinct examinations that would be replaced by the SIE and the corresponding qualification examinations (e.g., Series 6, 7 and 79).<sup>91</sup> These individuals would experience a net decrease in their total number of examination questions under the proposed rule.

Further, candidates who were registered as representatives two or more years, but less than four years, prior to reapplying for registration would experience a net decrease in their total number of examination questions if they re-registered because they would be considered to have passed the SIE or their SIE result would still be valid. Similarly, current registrants seeking an additional or alternative representative registration category would also experience a net decrease in their total number of examination questions because they would have already satisfied the SIE requirement, so they only have to take the appropriate specialized knowledge examination. These groups represent a relatively small percentage of individuals seeking registrations.<sup>92</sup>

The cost of developing and implementing the new examination structure, including the development and maintenance of a management system to track SIE results, would primarily fall

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Volumes for the Series 99 examination are based on three-year averages because the Series 99 examination was implemented more recently than the other examinations.

<sup>91</sup> This data is based on a three-year review period (2012-2015).

<sup>92</sup> These groups do not include Order Processing Assistant Representatives because they would not be considered to have passed the SIE.

upon FINRA. Any individual, including the general public and investors, could take a general knowledge examination thereby enhancing the pool of prospective representatives. FINRA does not have estimates on the number of individuals who are not associated persons, or are associated persons who are not required to register, who would take the SIE. However, FINRA anticipates that the participation of these individuals would defray the cost of the program to some extent.

Currently, individuals generally must be associated with a member to be eligible to take FINRA qualification exams. The new examination structure would permit the general public to take the SIE, enabling prospective securities industry professionals to demonstrate to prospective employers a basic level of knowledge prior to a job application. Further, individuals can use the SIE to assess their readiness to enter the securities industry.

FINRA understands that currently some firms cover the examination fees for their representative-level registrants. Under the proposed rule, firms may choose to incur the cost of both the SIE and specialized knowledge examinations for their representative-level registrants. Alternatively, firms may require potential registrants to pass the SIE before they can be considered for a position, in which case the SIE fee may be incurred by the individual and the associated impact may be a shifting of some of the costs associated with qualification from the firm to the individual.

The proposed rule continues to ensure that registered persons attain and maintain specified levels of competence and knowledge and, thus, it will continue to support investor protection. Moreover, FINRA expects the introduction of the SIE, which would reduce the complexity of the examination program and reduce content overlap, to increase the efficiency of the examination program and potentially create savings for members.

D. Registered Persons Functioning as Principals for a Limited Period  
(Proposed FINRA Rule 1210.04)

The proposed rule requires that a representative designated by a member to function as a principal for a limited period before having to pass a principal-level examination have at least 18 months of experience functioning as a registered representative within the five-year period immediately preceding the designation. FINRA believes that the proposed condition is necessary to ensure that such representatives have an appropriate level of registered representative experience. However, the proposed rule extends the limited period that such representatives may function as principals before having to pass the applicable principal examination from 90 calendar days to 120 calendar days. The proposed rule also allows an individual registered as a principal to function in another principal category for 120 calendar days before having to pass the applicable principal examination for that category, without having to satisfy the proposed experience requirement for representatives.

E. Lapse of Registration and Expiration of SIE (Proposed FINRA Rule 1210.08)

The proposed rule maintains a two-year lapse of registration period, but establishes a four-year expiration period for the SIE. Therefore, candidates who were registered as representatives two or more years, but less than four years, prior to reapplying for registration would only be required to take an appropriate specialized knowledge examination, and not the SIE. FINRA believes that establishing a four-year expiration period for the SIE will reduce the overall cost of registration, such as the SIE examination fee and test preparation costs, for individuals returning to the industry after two years, but less than four years, from the date of their last registration because they would not be required to retake the SIE.

F. Waiver of Examinations for Individuals Working for a Financial Services Industry Affiliate of a Member (Proposed FINRA Rule 1210.09)

The proposed rule provides a waiver program for individuals registered with a member who move to a financial services industry affiliate of a member, subject to specified conditions. The proposed rule waives the requalification requirements upon reassociation with a member, and thus may reduce the costs associated with requalification. Approximately half of the persons who gained a registration in 2015 held the same registration previously. Based on FINRA's experience with the examination waiver program, FINRA believes that a small percentage of these individuals had to terminate their registration(s) to work for a financial services industry affiliate of a member. These individuals and the firms with which they would associate would realize savings of the costs associated with examinations. However, there are costs associated with maintaining eligibility for the waiver, such as the cost of satisfying the Regulatory Element of CE.

G. Compliance Officer (Proposed FINRA Rule 1220(a)(3))

The proposed rule allows the CCO of a member that is engaged in limited investment banking or securities business to register in a principal category that corresponds to the limited scope of the member's business. Similar to the proposed change to the two-principal requirement, the proposed rule has the potential to benefit members that engage in more limited activities, by providing flexibility in choosing a principal registration category that is tailored to the scope of the firm's business.

H. Principal Financial Officer and Principal Operations Officer (Proposed FINRA Rule 1220(a)(4))

Under the proposed rule, members would be required to designate a Principal Financial Officer and a Principal Operations Officer. FINRA believes that the proposed rule would have a minimal impact on dual members of FINRA and the NYSE because they are currently required to designate a CFO and a COO under the Incorporated NYSE rules, which are analogous to a

Principal Financial Officer and a Principal Operations Officer. Members that are not dual members are currently required to only designate a CFO, which is analogous to a Principal Financial Officer. There are approximately 4,000 members, 3,800 of which are not dual members of FINRA and the NYSE. The proposed rule requires members that are not dual members of FINRA and the NYSE to designate a Principal Operations Officer in addition to a Principal Financial Officer. Accordingly, such members would bear the cost of identifying and designating an associated person as Principal Operations Officer, including the potential costs associated with the qualification and registration of such a person (i.e., a Principal Operations Officer must be qualified and registered as a Financial and Operations Principals or an Introducing Broker-Dealer Financial and Operations Principals, as applicable). However, the proposed rule allows members that neither self-clear nor provide clearing services to designate the same person as the Principal Financial Officer and Principal Operations Officer. In addition, a clearing or self-clearing member that is limited in size and resources could request a waiver of the requirement to designate separate persons to function as Principal Financial Officer and Principal Operations Officer.

I. Research Principal (Proposed FINRA Rule 1220(a)(6))

Currently, an individual who seeks registration as a Research Principal would take three examinations, the Series 7, 24 and 87, totaling 450 questions, or the Series 7, 16 and 24, totaling 500 questions. Under the proposed rule, an individual who seeks registration in the same category would take either two or four examinations, the Series 16 and 24, totaling 250 questions, or the SIE, the Series 24, 86 and 87, totaling 375 questions. Therefore, while some individuals registering as Research Principals may be required to take an additional examination,



all individuals seeking the Research Principal registration would experience a net decrease in their total number of examination questions under the proposed rule.

J. Eliminated Registration Categories (Proposed FINRA Rule 1220.06)

As discussed above, FINRA is proposing to eliminate the current registration categories of Order Processing Assistant Representative, United Kingdom Securities Representative, Canada Securities Representative, Options Representative, Corporate Securities Representative and Government Securities Representative. FINRA believes that the utility of these examinations has diminished based on changes to the industry, as evidenced by the low annual volume for each of these examinations and the relatively low number of individuals who currently hold these registrations. For example, in 2015, the volume of candidates for each of the examinations associated with these registration categories was as follows: Series 11 (100); Series 17 (20); Series 37 (50); Series 38 (20); Series 42 (2); Series 62 (300); and Series 72 (20). In addition, FINRA is proposing to eliminate the Foreign Associate registration category. There are approximately 500 Foreign Associates currently registered in the CRD system, which is less than 1% of the total number of registered persons.

While FINRA is proposing to eliminate these registration categories going forward, individuals registered in these categories would be eligible to maintain their registrations with FINRA, thus reducing the impact on them. Specifically, the proposed rule provides that individuals who are registered as Order Processing Assistant Representatives, United Kingdom Securities Representatives, Canada Securities Representatives, Options Representatives, Corporate Securities Representatives or Government Securities Representatives on the effective date of the proposed rule change and individuals who had been registered in such categories within the past two years prior to the effective date of the proposed rule change would be eligible

to maintain their registrations with FINRA. However, if individuals registered in these categories terminate their registration with FINRA and the registration remains terminated for two or more years, they would not be able to re-register in that category. Individuals registered as Foreign Associates on the effective date of the proposed rule change would also be eligible to maintain their registrations with FINRA, provided that if they subsequently terminate their registrations with FINRA, they would not be able to re-register as Foreign Associates.

K. Registration Requirements for Associated Persons Who Accept Customer Orders (Proposed FINRA Rule 1230.01)

The proposed rule rescinds existing guidance regarding the ability of unregistered persons to, on occasion and when a registered person is unavailable, accept an unsolicited customer order that is manually submitted. Moreover, the proposed rule prohibits unregistered persons from accepting customer orders under any circumstances. The proposed rule would impact firms that currently rely on unregistered persons to accept unsolicited manual orders from customers when a registered person is unavailable, unregistered persons who accept the orders and customers who place such orders with unregistered persons. Under the proposed rule, only appropriately registered persons can accept customer orders. Therefore, firms that accept unsolicited manual orders from customers must have appropriately registered persons available to accept such orders. If an appropriately registered person is unavailable to accept a customer order that is manually submitted, the proposed rule would allow an unregistered person to transcribe the order details, provided that an appropriately registered person subsequently contacts the customer to confirm the order details before entering the order. FINRA does not have data on how many firms, or how often firms, permit unregistered persons to accept unsolicited manual orders from customers based on the existing guidance. However, FINRA believes that investor protection concerns outweigh any additional burden on such firms.

### Alternatives Considered

The following are the most significant alternatives that were suggested by commenters or that FINRA considered on its own accord. Commenters also suggested other alternatives, which are discussed in Item II.C. below.

FINRA originally considered whether individuals with permissive registrations should be subject to a subset of FINRA rules. FINRA determined to adopt an alternative approach that is principles-based and provides firms the flexibility to tailor their supervisory systems to their business models. Under the revised approach, individuals maintaining a permissive registration would be considered registered persons and subject to all FINRA rules, but only to the extent relevant to their activities.

In addition, FINRA considered whether individuals who only maintain permissive registrations should be counted for purposes of a firm's number of registered persons. Currently, individuals who are permissively registered are counted for such purposes. FINRA determined that it is appropriate to continue to count such individuals for purposes of calculating the number of registered persons and assessing associated fees given that FINRA incurs costs for oversight and examinations relating to all registered persons.

FINRA originally considered whether to create an "active" and "inactive" registration status in the CRD system to distinguish between required and permissive registrations, and it determined not to do so. Rather, all individuals registered in the CRD system would be considered registered persons. Further, as noted above, FINRA will consider changes to the CRD system to require firms to identify whether a registered person is maintaining only a permissive registration, and it will consider changes to BrokerCheck to disclose the significance of such permissive registration.

FINRA also considered alternative models for restructuring the examinations and found the proposed approach to be the most efficient for achieving the goals of the proposal, including the elimination of duplicative testing of general securities knowledge. For instance, among other models, FINRA considered retaining the current Series 7 examination and revising the existing limited qualification examinations in addition to creating the SIE. FINRA also considered retaining the current limited qualification examinations and revising the existing Series 7 examination in addition to creating the SIE. Under both of these alternatives, an individual would be subject to duplicative testing of general securities knowledge if the individual registers in a limited category and later decides to register as a General Securities Representative.

FINRA considered whether individuals who are not associated persons of firms should be allowed to take the SIE. FINRA determined that allowing individuals who are not associated persons of firms to take the SIE would enhance the pool of prospective securities industry professionals. FINRA also established appropriate safeguards that are intended to discourage such individuals from misrepresenting their qualifications to the public. Specifically, FINRA would require that such individuals attest that they are not qualified to engage in the investment banking or securities business based on passing the SIE and that they will not make any misrepresentations to the public as to their qualifications. In addition, if FINRA determines that non-associated persons cheated on the SIE or that they misrepresented their qualifications to the public subsequent to passing the SIE, they may forfeit their SIE results and may be prohibited from retaking the SIE. Further, if FINRA discovers that non-associated persons who have passed the SIE have subsequently engaged in other types of misconduct, FINRA will refer the matter to the appropriate authorities or regulators.

FINRA considered alternatives to the proposed experience requirement for representatives that are designated by firms to function as principals for a 120-day period before having to pass an appropriate principal qualification examination. FINRA determined to allow firms to designate a principal to function in another principal category for 120 calendar days before passing any applicable examinations, without having to satisfy the proposed experience requirement for representatives.

Further, FINRA considered alternatives to the two-year period for lapse of registration and the four-year expiration period for the SIE. FINRA determined that based on the content of the SIE, a passing result on the SIE would be valid for four years. With respect to the representative- and principal-level registrations, FINRA determined that the registrations would continue to be subject to a two-year expiration period. However, FINRA will explore the possibility of extending the two-year expiration period through the use of more frequent CE.

With respect to the FSA waiver program, FINRA originally considered a proposal whereby individuals could maintain their registrations in an RA status, subject to complex tracking and tolling provisions. FINRA determined that the proposed FSA waiver program would significantly reduce the operational, administrative and cost burden on members, associated persons and FINRA, as compared to the original proposal.

FINRA originally considered adopting a Compliance Officer qualification examination for CCOs and other individuals registering as Compliance Officers. However, FINRA determined not to adopt a separate qualification examination pending its evaluation of the structure of the principal-level examinations.

FINRA also considered whether to retain some of the registration categories that it initially proposed to eliminate, including the registration categories of United Kingdom

Securities Representative, Canada Securities Representative, Options Representative, Corporate Securities Representative and Foreign Associate. As described above, the overall utility of these registration categories has diminished over the years, which is why FINRA proposes to eliminate them.

Finally, FINRA considered whether to revise the proposal regarding associated persons who accept customer orders to clarify its application to situations where an appropriately registered person is unavailable. FINRA determined to revise the proposal to clarify that an associated person is not accepting a customer order where occasionally, when an appropriately registered person is unavailable, the associated person transcribes the order details and the registered person contacts the customer to confirm the order details before entering the order.

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

Comments Relating to Consolidated Registration Rules

In December 2009, FINRA published Regulatory Notice 09-70, seeking comment on the proposed consolidated registration rules.<sup>93</sup> FINRA received 22 comment letters in response to the Notice, which are discussed below. A copy of the Notice is attached as Exhibit 2a.<sup>94</sup> A list of the comment letters received in response to the Notice is attached as Exhibit 2b.<sup>95</sup> Copies of the comment letters received in response to the Notice are attached as Exhibit 2c.

1. Permissive Registrations (Proposed FINRA Rule 1210.02)

A. General Comments

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<sup>93</sup> Some of the proposed changes discussed in this filing were not part of the proposals set forth in Regulatory Notice 09-70, including the proposed FSA waiver program.

<sup>94</sup> The Commission notes that the exhibits referred to are attached to the filing, not to this Notice.

<sup>95</sup> All references to commenters are to the comment letters as listed in Exhibit 2b.

GWFS Equities appreciated the proposed provisions regarding permissive registrations, but stated that the costs associated with implementing the provisions, including tracking the status of individuals in an RA status, outweighed the benefits. FSI was concerned that the proposed requirements may result in the deregistration of individuals who are currently permissively registered. Nationwide was concerned with the feasibility of the RA status and the potential administrative and cost burdens. Nationwide also stated that the proposal would prevent some individuals from registering in an RA status because of the potential burdens.

As discussed above, FINRA has replaced the RA proposal with the FSA waiver program, which would significantly reduce the operational, administrative and cost burden on firms and associated persons. Further, the proposed rule change would not require firms to maintain permissive registrations. Rather, it provides firms the flexibility to do so, subject to specified conditions. Each firm is free to determine whether to maintain any permissive registrations.

#### B. Tolling and Forfeiture Provisions Relating to RA status

Several commenters stated that the tolling and forfeiture provisions for individuals in an RA status were too complicated and burdensome.<sup>96</sup> ICI and USAA requested exceptions from the RA conditions for specified persons. T. Rowe, ARM and CAI asked that the time limitation for remaining in an RA status be eliminated. NSCP stated that the time limitation was arbitrary. In addition, SIFMA suggested that individuals in an RA status be permitted to restart a fresh time limit if they satisfied specified conditions. In light of these and other comments, FINRA has replaced the RA proposal with the FSA waiver program.

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<sup>96</sup> GWFS Equities, T. Rowe, ICI, ARM, FSI, USAA, Nationwide, NSCP, SIFMA and IMS-2.

### C. Other Comments Relating to Permissive Registrations

AEC requested that individuals who only maintain permissive registrations not be counted for purposes of a firm's approved number of representatives. AEC also suggested that FINRA place time limits on permissive registrations. Currently, individuals who are permissively registered are counted for purposes of calculating the number of registered persons and assessing associated fees. FINRA believes that it is appropriate to continue to do so given that FINRA incurs costs for oversight and examinations relating to all registered persons. FINRA does not believe that individuals with a permissive registration should be subject to a time limitation because they would be subject to supervision by a member as described in the proposed rule change.

T. Rowe requested that FINRA create an "active" category for all required registrations and a "retained" category for all permissive registrations. T. Rowe added that "retained" persons should be deemed associated persons, but subject only to a subset of FINRA rules. ARM similarly requested that FINRA create an "active" category for all required registrations and a "permissive" category for all permissive registrations. Edward Jones stated that there was no regulatory distinction between an active and inactive status and that the proposal should not create such a distinction. NSCP requested additional clarification regarding the inactive status and the provisions applicable to individuals who would maintain a permissive registration. T. Rowe and ARM stated that the term "inactive" should not be used because it may be confused with the term "CE inactive."

FINRA has eliminated the distinction between an active and inactive status. Rather, all individuals registered in the CRD system would be considered registered persons. As noted above, FINRA will consider changes to the CRD system to require firms to identify whether a



registered person is maintaining only a permissive registration, and it will consider changes to BrokerCheck to disclose the significance of such permissive registration.

Under the proposed rule change, any associated person of a member is eligible to obtain and maintain any registration permitted by the member. For instance, an associated person of a member working solely in a clerical or ministerial capacity, such as in an administrative capacity, could maintain a representative-level registration. Further, an associated person of a member who is registered, and functioning solely, as a representative could obtain and maintain a permissive principal-level registration with the member. In addition, the proposed rule change allows an individual engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of a member to obtain and maintain any registration permitted by the member.

Individuals maintaining a permissive registration under the proposed rule change would be considered registered persons and subject to all FINRA rules, but only to the extent relevant to their activities. For instance, FINRA rules that relate to interactions with customers would have no practical application to the conduct of a permissively registered individual who does not have any customer contact. However, members would be required to have adequate supervisory systems and procedures reasonably designed to ensure that individuals with permissive registrations do not act outside the scope of their assigned functions. FINRA had originally proposed that individuals with permissive registrations be subject to a subset of FINRA rules. FINRA believes that the revised approach, which is principle-based, provides firms the flexibility to tailor their supervisory systems to their business models.

SIFMA requested that the proposal more clearly define the different categories of required and permissive registrations, including the Compliance Officer registration category.

FINRA had originally proposed to allow individuals registering as Compliance Officers, other than CCOs, a choice between an active or inactive status, subject to specified conditions. Under the revised proposal, there is no longer a distinction between an active and inactive status. CCOs would be required to register as Compliance Officers or in a more limited principal category as specified in proposed FINRA Rule 1220(a)(3), and other associated persons would be allowed to permissively register as Compliance Officers.

Nationwide requested additional clarification regarding the supervision of individuals who maintain solely permissive registrations. Nationwide also noted that for purposes of compliance with FINRA Rule 3110(a)(5), the proposal should allow for risk-based supervision reasonably designed to ensure compliance, such as the use of periodic questionnaires and certifications to satisfy supervisory obligations.

A firm's supervisory procedures must be reasonably designed to achieve compliance with the requirements of the proposed rule change. FINRA does not believe that it is necessary to discuss whether any particular methodology, such as risk-based supervision, satisfies the requirements of the proposed rule change. Moreover, with respect to an individual who solely maintains a permissive registration, such individual's day-to-day supervisor may be a non-registered person. Though, for purposes of compliance with FINRA Rule 3110(a)(5), members would be required to assign a registered supervisor who would be responsible for periodically contacting such individual's day-to-day supervisor to verify that the individual is not acting outside the scope of his or her assigned functions. If such individual is permissively registered as a representative, the registered supervisor must be registered as a representative or principal. If the individual is permissively registered as a principal, the registered supervisor must be registered as a principal. However, in either case, the registered supervisor of an individual who

solely maintain [sic] a permissive registration would not be required to be registered in the same registration category as the permissively-registered individual.

Cornell asked whether individuals who solely maintain permissive registrations would be able to contact customers because they would be considered registered persons for purposes of FINRA rules. Individuals who contact existing or prospective customers would have to be authorized to do so by a member and maintain a required registration, unless otherwise permitted under FINRA rules. For purposes of contacting existing or prospective customers, individuals who solely maintain permissive registrations would be subject to the same limitations as unregistered persons.

SIFMA stated that assigning a registered supervisor to each individual in an RA status for purposes of FINRA Rule 3110(a)(5) would not be practical or effective in all cases. SIFMA suggested that the proposal be revised to require the assignment of a registered supervisor responsible for implementing a system of policies, procedures and controls reasonably designed to ensure that individuals in an RA status do not engage in activities that require registration. Alternatively, SIFMA suggested that the proposal be revised to require that individuals in an RA status be subject to the member's overall supervisory system, including written procedures designed to address compliance with the rules applicable to them and the requirement that they act within the limits of their status. GWFS Equities noted that maintaining registrations for individuals in an RA status while they are working for affiliated investment advisers could present potential conflicts between broker-dealer and advisory activities for firms that are not dually registered.

As noted above, FINRA has replaced the RA proposal with the FSA waiver program, which would not require firms to assign a registered supervisor to individuals working for a

financial services industry affiliate of a member. However, the proposed rule change would allow a member to permissively register an individual working for a foreign securities affiliate or subsidiary of the member, as currently permitted. If a member chooses to maintain such a permissive registration, it would be required to assign a registered supervisor to such permissively registered individuals, as described above.

Nationwide asked that the proposal be amended to expressly allow a firm to determine the scope of its bona fide business purpose. Cornell requested that FINRA define the term “bona fide business purpose.” ACI stated that the term “bona fide business purpose” may be applied inconsistently across firms and that FINRA should recognize this when considering enforcement. FINRA had originally proposed to permit the registration of associated persons engaged in a bona fide business purpose of a member. The revised proposal would allow any associated person to obtain and maintain any registration permitted by the member. FINRA believes that associated persons by definition are engaged in a bona fide business purpose of a member.

Edward Jones and SIFMA requested that a person who was registered within the past two years prior to the effective date of the proposal be eligible for permissive registration. Nothing in the proposed rule change would preclude a member from applying to register such a person once the proposed rule change becomes effective.

Edward Jones stated that individuals who had been registered two or more years, but less than four years, prior to the effective date of the proposal be eligible for permissive registration. FSI stated that individuals who had been registered two or more years, but less than five years, prior to the effective date of the proposal be eligible for permissive registration, subject to satisfying their CE requirements. Individuals who have been out of the brokerage industry for two or more years prior to the effective date of the proposed rule change would be eligible for

permissive registration, provided that they pass the requisite qualification examination or obtain a waiver upon re-registration. Moreover, individuals who had been registered as representatives two or more years, but less than four years, prior to the effective date of the proposed rule change would be considered to have passed the SIE and designated as such in the CRD system.

SIFMA and ABA stated that Section 3(a)(4) of the Act allows a nominal one-time referral fee to bank employees that are not associated persons. In addition, they noted that Rule 701 of SEC Regulation R allows more than the one-time referral fee to bank employees that are not registered for the referral of high net worth individuals or institutional customers. SIFMA and ABA requested that the proposal clarify that individuals in an RA status are not associated persons and not registered for purposes of these provisions. IMS asked whether the RA status should be limited to persons working at affiliates of a member. ABA requested that the proposal allow a member to maintain registrations for persons who work for an unaffiliated bank with which the member has contractually entered into a networking arrangement.

As discussed above, FINRA has replaced the RA proposal with the FSA waiver program. Under the revised proposal, an FSA-eligible person who is working for a financial services industry affiliate of a member would not be considered an associated or registered person.

NASAA stated that the proposal did not articulate a sound regulatory basis for expanding permissive registrations and that the current restrictions regarding the “parking” of registrations should stay in place. NASAA also stated that the waiver process was more appropriate to achieve the goals of the proposal, rather than an expansion of permissive registrations. NASAA further stated that the proposal did not comply with the Act’s provision that requires FINRA to prescribe standards of training, experience and competence for associated persons of members. In addition, NASAA stated that CE cannot be a substitute for qualification examinations because

CE is not tailored to address the eventual function of permissively registered individuals at the member. NASAA noted that, at the very least, the proposal should include enhancements to existing CE requirements. IMS asked whether it was necessary to revise the current requirements applicable to permissively registered persons.

FINRA believes that there is a sound regulatory purpose for permitting permissive registrations for several reasons. First, the proposed rule change would in effect allow firms to maintain an individual's registration in a standby status in the event the firm has a foreseeable need to move the individual to a position that requires registration, without having to go through the registration process each time the individual moves between a firm's business units. FINRA believes that this would simplify compliance with registration requirements. Second, the proposed rule change would allow associated persons to gain greater regulatory literacy, which would, in turn, enhance a firm's culture of compliance. Third, the proposed rule change would eliminate a regulatory inconsistency in the current rules, which permit some associated persons of a member to maintain permissive registrations, but not others who equally are engaged in the member's business. For instance, an individual working in a firm's internal audit department may be permissively registered, whereas an individual working in the Corporate Secretary's office of a firm is currently not permitted to do so.

The proposed rule change has other regulatory benefits. While all registered persons are subject to firm supervision under the current rules, the rules do not explicitly address the obligations of firms to supervise permissively registered persons, including individuals who are working in a non-registered capacity at the firm or who are working for a foreign securities affiliate or subsidiary of the firm. In conjunction with the expansion of permissive registrations, the proposed rule change expressly sets forth the obligation of firms to supervise permissively

registered persons and specifies the manner in which firms must supervise such individuals, which will, in turn, improve regulatory compliance. Further, by replacing the RA proposal with the FSA waiver program, FINRA has limited the scope of permissive registrations.

FINRA believes that the proposed rule change satisfies its obligation under the Act to prescribe standards of training, experience and competence for the following reasons. Foremost, individuals who maintain solely permissive registrations are subject to the same qualification examinations as individuals who are required to register. As such, the proposed rule change would not substitute CE requirements for qualification examinations; rather, CE remains a supplement to the examinations. Also, similar to individuals who are required to register, members would be required to conduct background investigations pursuant to FINRA Rule 3110(e) on individuals who maintain solely permissive registrations to establish, among other things, their qualifications and experience. Moreover, such individuals are equally subject to supervision by a member, including the requirement to participate in an annual compliance meeting. Further, as discussed above, such individuals would be subject to the Regulatory Element of the CE requirements. The required Regulatory Element would correspond to their registration status.<sup>97</sup>

Several commenters requested more details regarding the notification and tracking process for individuals with permissive registrations.<sup>98</sup> Edward Jones stated that the affirmative notification requirements of the proposal were too complicated and that the proposal should

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<sup>97</sup> The Regulatory Element of CE includes the following four programs: the S106 (for Investment Company and Variable Contracts Representatives), the S201 (for registered principals and supervisors), the S901 (for Operations Professionals) and the S101 (for all other registered persons). FINRA recently enhanced the S101 program by including personalized content that covers retail sales, institutional sales, trading, operations and investment banking and research.

<sup>98</sup> T. Rowe, ARM, Edward Jones, NSCP, Cornell, SIFMA and CAI.

allow firms to maintain the required information regarding the status of such individuals and make it available upon request during the course of examinations. CAI asked whether the CRD system would be updated to track permissive registrations. CAI also requested that FINRA provide sufficient time for the implementation of the proposal. SIFMA requested that the CRD system and BrokerCheck be modified to accommodate and disclose permissive registrations. NSCP stated that the current CRD system would not be able to handle the workload, and it asked that the notification process be further developed before the proposal is filed with the SEC. ARM requested that FINRA make the necessary system changes to accommodate the proposed tracking requirements.

The original proposal included a complex notification and tracking process that required firms to indicate to FINRA whether a registered person had an active or inactive status and whenever that status changed. FINRA has revised the proposal and simplified the overall process. Under the proposed rule change, all individuals who are registering with FINRA would go through the same process: there would be no distinction between an individual with a required registration and an individual with a permissive registration for purposes of the registration process. However, as noted above, FINRA will consider changes to the CRD system to require firms to identify whether a registered person is maintaining only a permissive registration, and it will consider changes to BrokerCheck to disclose the significance of such permissive registration to the general public. Moreover, FINRA will consider the need for firms to make procedural and systems changes in establishing an implementation date for the proposed rule change.

Nationwide asked whether FINRA intends to assert jurisdiction for purposes of examining individuals in an RA status. CAI stated that FINRA's oversight of and authority over individuals who solely maintain permissive registrations should be limited to activities that



directly involve the securities activities of the member. Individuals would not be permitted to register in an RA status under the revised proposal. Further, individuals who solely maintain a permissive registration under the proposed rule change would be subject to FINRA's jurisdiction by virtue of their status as associated persons.

NSCP noted that the definition of "financial services industry" for purposes of the RA status appeared to be broad enough to encompass the range of activities in which financial service providers are engaged, but suggested that the definition be broadened to facilitate the inclusion of other regulatory bodies, such as the Consumer Financial Protection Bureau. NSCP suggested that this could be achieved by FINRA having the authority to recognize a particular entity or type of entity as being in the financial services industry for purposes of the proposal, without the need to go through future rulemaking. As noted above, while FINRA has replaced the RA proposal with the proposed FSA waiver program, the definition of the term "financial services industry affiliate" is similar to the definition under the RA proposal. Further, FINRA believes that the proposed definition is sufficiently broad and should not be revised in a manner that may extend the definition beyond financial services.

2. Requirements for Registered Persons Functioning as Principals for a Limited Period (Proposed FINRA Rule 1210.04)

GWFS Equities, ARM and NSCP were concerned that the proposed experience requirement is an additional prerequisite requirement for registration as a principal. Proposed FINRA Rule 1210.04 does not impose an experience requirement for those persons designated to function as principals after passing an appropriate principal qualification examination. Rather, it creates an experience requirement for those representatives that are designated by firms to function as principals for a 120-day period before having to pass an appropriate principal qualification examination. Thus, the experience requirement is narrow in scope.

T. Rowe stated that requiring an individual to satisfy all applicable prerequisites to be eligible to be designated as a principal under the proposal was unwarranted. T. Rowe was also concerned with the proposed experience requirement. NASD Rule 1021(d)(2) currently provides that persons not currently associated with a member as representatives are allowed to be designated as principals for 90 days prior to passing the applicable principal examination, but only after all applicable prerequisites have been fulfilled. Proposed FINRA Rule 1210.04 simply clarifies that any person that is to be designated as principal for the proposed limited period must fulfill all applicable prerequisite registration, fee and examination requirements, such as passing the General Securities Representative examination, prior to his or her designation as a principal. In addition, the experience requirement is intended to ensure that a registered representative functioning as a principal for the 120-day time period before having to pass a principal examination has an appropriate level of experience to carry out such functions.

ARM asked whether the experience requirement applies to all principal designations or only those that have a prerequisite representative registration requirement. The experience requirement applies to all principal designations, including those without a prerequisite representative registration requirement (e.g., Financial and Operations Principal). FINRA has revised the proposed rule to clarify this point.

FSI stated that small firms may find it difficult to find an experienced representative and that small firms should be provided a limited size and resources exception. FINRA does not believe the experience requirement, which is only applicable in limited situations, imposes any undue burden on small firms. Moreover, as noted above, the requirement is intended to ensure that the representative has an appropriate level of experience to carry out the assigned principal functions. However, in light of the comment, FINRA has revised the proposed rule to allow

firms to designate a principal to function in another principal category for 120 calendar days before passing any applicable examinations, without having to satisfy the proposed experience requirement.

3. Waiting Periods for Retaking a Failed Examination (Proposed FINRA Rule 1210.06)

FSI asked whether the 180-day waiting period was triggered upon three successive examination failures within 30 calendar days of each other or three successive examination failures in any given period. In response, FINRA has revised the proposed rule to provide that the 180-day waiting period is triggered upon three successive examination failures within a two-year period.

4. Compliance Officer (Proposed FINRA Rule 1220(a)(3))

NSCP sought additional clarification regarding the Compliance Officer registration requirement and whether individuals could be permissively registered as Compliance Officers. Proposed FINRA Rule 1220(a)(3) would only require that CCOs register as Compliance Officers or in a more limited principal category as specified in the rule. However, consistent with proposed FINRA Rule 1210.02 relating to permissive registrations, a firm may allow other associated persons to register as Compliance Officers.

GWFS Equities stated that the requirement that CCOs pass the General Securities Principal qualification examination even if a firm's activities are limited to mutual funds and variable contracts seems unwarranted. As noted above, FINRA has revised the proposed rule to permit the CCO of a member that is engaged in limited investment banking or securities business to have a more limited principal-level qualification.

NSCP asked whether the Compliance Officer registration category would be a principal-level category. The Compliance Officer registration category would be a principal-level category.

FINRA had originally proposed to permit firms to designate Compliance Officers who are permissively registered in an active status, provided they were engaged in compliance activities. FSI asked whether such Compliance Officers were required to forego their active status if they moved to another department within the firm. As discussed above, FINRA has eliminated the proposed active and inactive status.

ARM, Pershing and SIFMA suggested that the proposal did not adequately explain whether the current NYSE Compliance Official category would be eliminated. The Incorporated NYSE rules relating to the Compliance Official registration requirement (former Incorporated NYSE Rule 342.13(b) and NYSE Rule Interpretation 342(a)(b)/02) were deleted as part of the proposed changes to the supervision rules. Subject to the lapse of registration provisions in proposed FINRA Rule 1210.08, individuals registered as Compliance Officials in the CRD system on the effective date of the proposed rule change and individuals who were registered as such within two years prior to the effective date of the proposed rule change, would be qualified to register as Compliance Officers without having to take any additional examinations. FINRA understands that the NYSE will separately determine how to address the current Compliance Official requirement under its rules.

NSCP suggested that registration as a Corporate Securities Representative or Private Securities Offerings Representative should also be acceptable to satisfy the prerequisite representative-level registration for Compliance Officers. CAI suggested that registration as an Investment Company and Variable Contracts Products Representative should also be acceptable

to satisfy the prerequisite representative-level registration for Compliance Officers of firms that are engaged solely in activities relating to investment company and variable contracts products. FINRA is proposing to eliminate the Corporate Securities Representative registration category. However, as discussed above, FINRA has revised proposed FINRA Rule 1220(a)(3) to allow the CCO of a member that is limited in the scope of its activities to have a more limited principal-level qualification, which would include a more limited representative-level prerequisite registration.

CAI also asked whether a CCO who has been grandfathered as a Compliance Officer under the proposal could maintain that registration if the CCO changed firms. CCOs who are grandfathered as Compliance Officers under the proposed rule change would not lose those registrations, unless their registrations lapse under proposed FINRA Rule 1210.08.

ACI suggested that the Compliance Officer grandfathering provision should allow for the grandfathering of unemployed compliance officers. For purposes of grandfathering and subject to the lapse of registration provisions in proposed FINRA Rule 1210.08, the proposed rule change would only recognize individuals who are registered in the CRD system on the effective date of the proposed rule change and individuals who were registered within two years prior to the effective date of the proposed rule change. FINRA would evaluate the status of other former compliance personnel on a case-by-case basis through the waiver process.

5. Principal Financial Officer and Principal Operations Officer (Proposed FINRA Rule 1220(a)(4)(B))

Pershing asserted that larger clearing firms may need to designate multiple Principal Financial Officers and Principal Operations Officers, and it asked whether the proposed rule would allow multiple designations. In addition, Pershing asked whether the proposed rule would allow the Principal Financial Officer or Principal Operations Officer to delegate the day-to-day duties to other principals at the firm, such as a General Securities Principal or a Financial and Operations Principal. A member may designate multiple Principal Operations Officers, provided that the member precisely defines and documents the areas of primary responsibility and makes specific provision for which of the officers has primary responsibility in areas that can reasonably be expected to overlap. A member, however, may not designate multiple Principal Financial Officers, given the importance of having one principal who is responsible for the financial statements as a whole. The Principal Financial Officer and Principal Operations Officer may delegate the day-to-day duties to other principals at the firm with the understanding that ultimate responsibility for the function rests with the Principal Financial Officer and Principal Operations Officer.

CAI stated that the Principal Operations Officer requirement should be limited to persons who are responsible for handling or processing customer funds or securities. CAI also stated that an officer responsible only for administrative and technical matters should not be subject to the requirement. FINRA believes that the proposed rule clearly articulates the functions that must be assigned to a Principal Operations Officer.

T. Rowe stated that a firm's Principal Operations Officer should register as a General Securities Principal. FINRA continues to believe that the Financial and Operations Principal or Introducing Broker-Dealer Financial and Operations Principal, as applicable, is the more

appropriate registration for a person designated as a Principal Operations Officer. FINRA notes that a Principal Financial Officer and a Principal Operations Officer would also be subject to the Operations Professional registration requirement.

IMS requested that the proposed rule exempt non-custodial clearing firms operating pursuant to SEA Rule 15a-6 from the requirement that clearing and self-clearing firms designate separate persons to function as Principal Financial Officer and Principal Operations Officer. The proposed rule provides that a clearing or self-clearing firm that is limited in size and resources may request a waiver of the requirement to designate separate persons to function as Principal Financial Officer and Principal Operations Officer. Consistent with the proposed rule, FINRA believes that it is more appropriate to consider waiver requests by firms on a case-by-case basis, rather than including a blanket exception in the proposed rule.

6. Elimination of Foreign Associate Registration Category (Proposed FINRA Rule 1220.06)

ARM and Konig stated that the Foreign Associate registration category should be retained. FINRA had originally proposed to eliminate this registration category and to require that persons registered as Foreign Associates in the CRD system qualify and register in an appropriate registration category, such as the General Securities Representative category, within one year of the effective date of the proposed rule change. FINRA continues to believe that the category should be eliminated and that such persons should demonstrate the same level of competence and knowledge required of their counterparts in the United States. However, as described above, FINRA has revised the proposal to permit Foreign Associates registered with FINRA on the effective date of the proposed rule change to maintain their registrations with FINRA. FINRA believes that the revised proposal reduces the impact on current Foreign Associates. As an alternative, Konig requested that examinations be made available in foreign

languages. Konig also incorrectly stated that Foreign Associates are exempt from the requirements of U.S. securities laws and should continue to be exempt from such requirements. As explained above, a Foreign Associate is considered a registered representative and subject to all the requirements to which registered representatives are subject, with the exception of the requirement to pass a qualification examination and comply with the Regulatory Element of the CE requirements. In addition, FINRA does not believe that it is practical to develop examinations in foreign languages. However, consistent with current policy, an examination candidate for whom English is a second language may request up to 60 minutes of additional examination time depending on the time allotted for taking the examination.

7. Associated Persons Exempt from Registration (Proposed FINRA Rules 1230 and 1230.01)

The original proposal in Regulatory Notice 09-70 provided that the function of accepting customer orders is not considered a clerical or ministerial function and that associated persons who accept customer orders under any circumstances are required to be appropriately registered. This is a rescission of the guidance provided in NTM 87-47.

NSCP stated that the existing guidance should remain intact. ACI believes that rescinding the guidance could cause significant disruption to firms' operations and that it requires further consideration. FINRA continues to believe that associated persons who accept customer orders under any circumstances should be appropriately registered and continues to propose the rescission of the guidance provided in NTM 87-47. However, FINRA has revised the proposal to clarify that an associated person is not accepting a customer order where occasionally, when an appropriately registered person is unavailable, the associated person transcribes the order details and the registered person contacts the customer to confirm the order details before entering the order.



## 8. Miscellaneous Comments

Dresdner stated that the proposal should allow a member to maintain registrations of associated persons specifically required by an exchange even after the member has terminated its exchange membership. The proposed rule change would allow such members to maintain those registrations that are also recognized by FINRA as acceptable registrations (e.g., General Securities Sales Supervisor). FINRA is not in a position to opine on the status of registrations that are not recognized by FINRA upon a member's termination of its exchange membership.

IMS requested that there be examination reciprocity between the SROs. Some examinations (e.g., the General Securities Sales Supervisor examinations) are recognized by most SROs. FINRA believes that it is more appropriate to evaluate examinations that are specific to an exchange on a case-by-case basis through the waiver process.

IMS also suggested that FINRA consider alternatives to the current lapse of registration period. For instance, IMS recommended that the two-year period be extended by a year for each three years that a person is registered. IMS further recommended that the two-year period should be replaced with a CE requirement similar to other professions (e.g., attorneys and certified public accountants). As described above, FINRA is proposing that a passing result on the SIE be valid for four years, while the representative- and principal-level registrations would continue to be subject to a two-year expiration period. However, FINRA is considering the possibility of extending the two-year expiration period through the use of more frequent CE.

ARM was concerned that some NYSE supervisory registrations, such as the Compliance Official registration, held by individuals associated with a member that is not a dual member of FINRA and the NYSE may not be recognized by the CRD system for grandfathering purposes. As discussed above, FINRA prefers to evaluate the status of a person who would not be

recognized for grandfathering purposes on a case-by-case basis through the waiver process. ARM also asked whether the waiver guidelines for the analytical portion of the Research Analyst qualification examination (Series 86) would continue to be applicable. FINRA is not proposing any changes to the current provisions for obtaining a waiver from the analytical portion of the Research Analyst qualification examination.

T. Rowe. asked whether its officers who have the authority to execute agreements with its clearing firm, including margin arrangements, and who also have the authority to allow specified securities lending and borrowing activities would be subject to the proposed registration requirements for Securities Lending Representatives and Securities Lending Supervisors. As noted above, FINRA is no longer proposing to adopt these registration categories. However, the individuals identified by T. Rowe may be required to register as Operations Professionals if they are functioning as Operations Professionals as set forth in proposed FINRA Rule 1220(b)(3).

The proposed rule change codifies existing guidance in NTM 99-49 regarding active management of a member's business. NSCP noted that the NTM included other relevant guidance and asked whether the other guidance would remain in effect. FINRA emphasizes that existing guidance and interpretations regarding registration requirements would continue to apply to the extent that they are not inconsistent with the proposed rules.

Further, NSCP asked that the proposal provide minimum requirements for personnel background investigations. In 2015, FINRA adopted FINRA Rule 3110(e), which sets forth the minimum requirements for background checks. NSCP also asked whether the proposal would impact referral fees. An associated person must be appropriately registered to be eligible to receive transaction-based compensation. Moreover, proposed FINRA Rule 1220.06 would expressly prohibit the payment of specific transaction-based compensation to Order Processing

Assistant Representatives. In addition, NSCP requested further guidance regarding the supervision of unregistered persons. Unregistered persons engaged in a member's investment banking or securities business are considered associated persons. FINRA rules and Notices provide extensive guidance regarding supervisory requirements, including the supervision of associated persons that are not registered.

#### Comments Relating to Examination Restructuring

In May 2015, FINRA published Regulatory Notice 15-20, seeking comment on a proposal to restructure the representative-level qualification examinations. FINRA received 20 comment letters in response to the Notice, which are discussed below. A copy of the Notice is attached as Exhibit 2d. A list of the comment letters received in response to the Notice is attached as Exhibit 2e.<sup>99</sup> Copies of the comment letters received in response to the Notice are attached as Exhibit 2f.

#### A. Requirement and Eligibility to Take the SIE and Specialized Knowledge Examinations

The majority of commenters supported creating the SIE and specialized knowledge examinations and streamlining the registration categories and associated qualification examinations as specified in the proposal.<sup>100</sup> SUI similarly supported the proposal, but it questioned the elimination of the Options Representative and Canadian Securities Representative registration categories as well as the associated examinations. Eder was likewise supportive of the proposal, but suggested that FINRA also eliminate the Direct Participation Programs Representative, Securities Trader, Investment Banking Representative, Private Securities

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<sup>99</sup> All references to commenters are to the comment letters as listed in Exhibit 2e.

<sup>100</sup> Monahan & Roth, Tessler, Arrow Investments, SIFMA, XT Capital, ICI, CFA, Edward Jones, FSI, PFS, Wells Fargo and ARM. Tessler, Arrow Investments and XT Capital also supported the other comments made by Monahan & Roth. Further, Wells Fargo and ARM supported the other comments made by SIFMA.

Offerings Representative, Research Analyst and Operations Professional registration categories as well as the associated examinations, and instead require individuals performing these functions to register as General Securities Representatives by taking the specialized Series 7 examination.

Lincoln Financial and CAI supported the overall goals of the proposal, including eliminating the registration categories and qualification examinations specified in the proposal, but they questioned whether requiring individuals registering with FINRA as new representatives to take the SIE and a specialized knowledge examination would be the most efficient way of achieving the proposal's goals. Lincoln Financial noted that FINRA may be able to achieve its goals by revising only the current limited representative-level examinations, such as the Series 55, Series 79, Series 86 and Series 87, and Series 99, rather than revising all the current representative-level examinations. Lincoln Financial suggested that, as an alternative, individuals who take more limited examinations today, such as the current Series 6 or Series 99 examination, should not be required to take the SIE. CAI is concerned that requiring a General Securities Representative or an Investment Company and Variable Contracts Products Representative to take the SIE and a specialized knowledge examination could impose additional burdens that may not necessarily achieve the regulatory objectives of the proposal.

FINRA considered a variety of models for restructuring the examinations and found the proposed approach to be the most effective method in achieving the main goals of the proposal, which are to eliminate duplicative testing of general securities knowledge on examinations, provide prospective securities industry professionals the ability to demonstrate fundamental securities knowledge and to do so in an equitable and uniform manner. For instance, if FINRA were to exclude the General Securities Representative registration category from the scope of the

proposal, an individual who registers in a limited registration category, by passing the SIE and a specialized knowledge examination, would be subject to duplicative testing of general securities knowledge if he or she later decides to register as a General Securities Representative. Similarly, if FINRA were to remove the limited registration categories from the scope of the proposal, an individual who registers in a limited category and later decides to register as a General Securities Representative would be subject to duplicative testing of general securities knowledge by having to pass the SIE and the specialized Series 7 examination.

In addition, the majority of commenters were generally supportive of allowing associated persons who will not be performing a registered representative job function as well as individuals who are not associated persons of firms to take the SIE.<sup>101</sup> ICI stated that FINRA should take steps to ensure that individuals who are permitted, but not required, to take the SIE do not make any misstatements to the public regarding their qualifications based on passing the SIE. ICI added that FINRA should clarify, either through an affirmation on the examination application or a new rule, that individuals who are not associated persons of firms are prohibited from holding themselves out to the public as having passed the SIE. In this regard, ICI also suggested that FINRA determine how to address any potential misconduct by individuals who are not associated persons of firms. FSI and Lincoln Financial similarly requested that FINRA address the potential risks of allowing individuals who are not associated persons of firms to take the SIE.

Monahan & Roth opposed allowing individuals who are not associated persons of firms to take the SIE because the proposed SIE Rules of Conduct do not address restrictions on the manner in which an individual who has passed the examination might hold himself or herself out

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<sup>101</sup> Eder, SIFMA, ICI, CFA, Edward Jones, FSI, Lincoln Financial, DCI, CAI, PFS, Wells Fargo, SUI and ARM.

to the public and because there is no supervisory system to monitor non-compliance by such individuals. Monahan & Roth also stated that allowing such individuals to take the SIE may result in investor confusion and potential misrepresentations to the public. Monahan & Roth requested that FINRA address whether the status of such individuals would be reflected in BrokerCheck and specify the restrictions on the availability of information on them.

FINRA believes that allowing individuals who are not associated persons of firms to take the SIE will enhance the pool of prospective securities industry professionals by, among other things, familiarizing them with securities regulation and appropriate conduct at an early stage of career development. The SIE Rules of Conduct would require individuals, including non-associated persons, to attest that they are not qualified to engage in the investment banking or securities business based on passing the SIE and that they will not make any misrepresentations to the public as to their qualifications. Further, FINRA will engage in a communications campaign to ensure that the public, including retail investors, are [sic] well-informed of the SIE and its limitations. In addition, if FINRA determines that non-associated persons cheated on the SIE or that they misrepresented their qualifications to the public subsequent to passing the SIE, they may forfeit their SIE results and may be prohibited from retaking the SIE. Also, if FINRA discovers that non-associated persons who have passed the SIE have subsequently engaged in other types of misconduct, FINRA will refer the matter to the appropriate authorities or regulators.

BrokerCheck would not publicly reflect the status of individuals who have only taken the SIE, including individuals who are not associated persons, because passing the SIE alone does not qualify them for registration with FINRA via the CRD system. With respect to the availability of information on individuals who have only taken the SIE, access to this

information would be limited. A firm would be able to view the passing status of an associated person who is not registering as a representative and an individual seeking to associate with the firm using an interface within the CRD system. A firm would also be able to obtain SIE results for an individual if the firm submits a Form U4 and requests a registration for that individual. In addition, FINRA and other SROs that recognize the SIE would be able to obtain an individual's SIE results.

IMS agreed that individuals should not have to be associated with a FINRA member to take the SIE, but it disagreed with the rest of the proposal. IMS stated that professional proficiency can be maintained through the use of mandatory CE requirements and that an individual's qualification status should not expire so long as the individual completes his or her CE, regardless of whether the individual remains in the industry.

FINRA is considering the possibility of whether more frequent CE could be used to ensure that individuals who leave the industry for a limited period maintain specified levels of competence and knowledge to carry out their job functions upon returning to the industry.

N.I.S. opposed the proposal altogether. It stated, among other things, that its representatives are currently required to pass the Uniform State Law Examination (Series 63) and Series 6 examination, which provide them with the necessary knowledge to perform their functions, and that requiring its new representatives to also take the SIE would be time consuming and costly.

#### B. Scope and Content of the SIE and Specialized Knowledge Examinations

Monahan & Roth suggested that FINRA add the following topics to the SIE outline: (1) overview of other financial industry participants, such as advisers and portfolio managers; (2) requirements relating to communications with the public, including categories of

communications and electronic communications; (3) discussion of confidentiality and privacy; and (4) restrictions relating to borrowing from or lending to customers. In addition, Monahan & Roth stated that content on the SIE outline related to customer accounts, such as account types, should be moved to a specialized knowledge examination relating to general sales because many firms do not open customer accounts.

The purpose of the SIE is to establish that an individual has fundamental securities-related knowledge, including knowledge of the applicable laws, rules and regulations. Further, the SIE would likely be limited to 75 scored questions established through the use of testing industry standards in consultation with a committee of industry and SRO representatives. While knowledge of other financial industry participants has general educational value, FINRA does not believe that testing such knowledge is relevant to the purpose and scope of the SIE. FINRA expects that the SIE would cover the topic of communications with the public, confidentiality and privacy of consumer information and restrictions on borrowing from or lending to customers. FINRA does not believe that SIE content relating to customer accounts should be removed. The content relating to customer accounts is essential to understanding the different types of customers in the securities industry, such as retail and institutional customers, and a firm's related obligations.

SIFMA considered the content of the SIE outline to cover fundamental securities industry knowledge. However, SIFMA noted that an individual taking the SIE should not be expected to have detailed knowledge of the rules listed in the outline, such as the SEC's net capital rule (SEA Rule 15c3-1), but rather be expected to have a general awareness of such rules. FSI and ARM had similar comments. Eder was concerned that the listing of broad rules and rule sets in the SIE outline, such as SEA Rule 15c3-1 and the MSRB rules, would be confusing to individuals



preparing for the SIE and stated that FINRA should provide more direction on the scope of the covered topics. CFA considered the content of the SIE outline to be common knowledge.

However, it recommended that FINRA add content on quantitative concepts (such as time value of money), how best to serve client investment needs, and risk management.

In general, SIE content relating to professional conduct, characteristics of products and economic factors would be tested in more detail, whereas other content, such as the net capital rule, would be tested at a high level. FINRA believes that an understanding of quantitative concepts is more appropriate for individuals taking a specialized knowledge examination, such as the specialized Series 79 or specialized Series 86 examination. With respect to knowledge of client investment needs, the SIE would cover suitability requirements at a high level. In addition, FINRA believes that the concept of risk management is better suited for a representative- or principal-level examination.

Lincoln Financial did not consider many of the topics covered in the SIE outline to be common knowledge to some representatives, including representatives that do not work at a full-service broker-dealer. It asked that FINRA develop an outline that focuses on higher level topics common to all broker-dealers. DCI was concerned that the SIE covers complex content, such as options and municipal securities, that most representatives need not master today. SUI noted that the SIE outline does not cover Exchange-Traded Notes or derivatives in general (other than options). SIFMA and ARM asked that FINRA solicit comment on the content of the proposed specialized knowledge examinations through a Regulatory Notice. PFS noted that the number of questions on the SIE should be reduced and determined by testing industry standards.

FINRA is developing the SIE with input from a committee that includes representatives from a broad spectrum of small, mid-sized and large firms. Based on the committee's feedback

as well as the comments received from the other commenters, FINRA believes that the SIE content, including general coverage of options and municipal securities, represents broad-based knowledge of the securities industry. The SIE content would cover Exchange-Traded Notes. However, the content on derivatives would be limited to a general knowledge of options, which is the most common derivative. Consistent with testing industry standards, the specialized knowledge examinations would be developed with input from committees of industry representatives who have expertise on the covered subject matters based on their day-to-day roles, responsibilities and job functions. Further, consistent with FINRA's practice regarding examination-related filings, the specialized knowledge examinations would be filed with the SEC for immediate effectiveness. FINRA determined the number of questions on the SIE, which likely will be 75 questions, based on testing industry standards for establishing test reliability.

#### C. Expiration Period of the SIE and Specialized Knowledge Examinations

Eder and CFA agreed with the proposed four-year expiration period for the SIE. CAI stated that a four-year or longer period may be appropriate if the SIE will test fundamental concepts, but if the content of the SIE is more likely to change or be updated a shorter period, such as three years, may be appropriate. SUI stated that four years is a reasonable length of time and that five years should be the absolute maximum period. SIFMA and Wells Fargo suggested that the SIE period be extended to five years. They also requested that the expiration period for the specialized knowledge examinations, which is two years as proposed, be aligned with the SIE and extended to five years. SIFMA noted that if FINRA extends the time period to five years, individuals who are not associated with a member during the five-year period could satisfy a CE requirement to maintain their proficiency. ARM requested that FINRA consider a six-year period for the SIE and a five-year period for the specialized knowledge examinations.

Based on the content covered on the SIE, FINRA continues to believe that a passing result on the SIE should be valid for four years. In addition, FINRA believes that the specialized knowledge examinations should be subject to a two-year expiration period similar to the current examinations. However, as noted above, FINRA is considering the possibility of extending the two-year expiration period through the use of more frequent CE.

#### D. Elimination of Registration Categories and Associated Examinations

SUI recommended that FINRA maintain the Options Representative registration category and develop a specialized knowledge examination for individuals advising the public on options trading, similar to the Canadian model. SUI also stated that FINRA should retain the Canadian Securities Representative registration categories and the associated examinations so that individuals have an understanding of the different legal frameworks in which they operate. Alternatively, SUI asked that if FINRA grandfathers existing Canadian Securities Representatives, FINRA should allow individuals who terminate their registrations a period of four or five years to re-register as Canadian Securities Representatives. Further, DCI stated that its business is limited to activities in which a Corporate Securities Representative may engage, and it is concerned that the proposed elimination of the Corporate Securities Representative registration category and associated Series 62 examination might dissuade prospective representatives from joining the firm if they have to take a more comprehensive examination, such as the specialized Series 7 examination.

The overall utility of the Options Representative and Corporate Securities Representative registration categories has diminished over the years, which is why FINRA is proposing to eliminate them. For instance, fewer than five individuals registered as Options Representatives in 2014. FINRA believes that the Canadian Securities Representative registration categories

should be eliminated and replaced with an alternative qualification process. Under the proposed rule change, an individual qualified in Canada would be exempt from taking the SIE and would be able to register in any registration category by taking and passing only the applicable specialized knowledge examination(s). FINRA believes that this alternative approach would provide individuals qualified in Canada more flexibility to obtain a FINRA representative-level registration. Further, as noted above, FINRA is considering the possibility of extending the current two-year expiration period for registrations.

Eder suggested that FINRA only retain the Investment Company and Variable Contracts Products Representative and General Securities Representative registration categories. FINRA disagrees and notes that the limited registration categories that FINRA is proposing to retain continue to have a regulatory purpose. For instance, the Equity Trader registration category, the predecessor to the Securities Trader category, was created for individuals engaged in securities trading activities over-the-counter or on Nasdaq with the view that better training and qualification of such individuals was necessary. The Research Analyst registration category was created for associated persons engaged in research activities in conjunction with FINRA's research analyst rule, FINRA Rule 2241, addressing conflicts of interest.

#### E. Principal-Level Examinations and Other Qualification Examinations

Several commenters asked that FINRA consider similar changes to the principal-level examinations.<sup>102</sup> Tessera further asked that FINRA and the MSRB consider any duplicative content that may exist on a principal-level examination for supervisors of Municipal Advisors and on the current Series 24 examination.

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<sup>102</sup> Tessera, SIFMA, Edward Jones, FSI, Wells Fargo and ARM.

Monahan & Roth suggested that FINRA also adopt a similar structure (that is, general knowledge and specialized knowledge examinations) for the proposed Compliance Officer registration category. In addition, Monahan & Roth requested that FINRA work with the MSRB to: (1) add the Municipal Advisor (Series 50) qualification examination to the list of proposed specialized knowledge examinations;<sup>103</sup> (2) grandfather General Securities Representatives and Municipal Securities Principals from the requirement to take a specialized Series 50 examination; and (3) avoid redundancies in developing the content outline of a specialized Series 50 examination. SIFMA asked that FINRA and the MSRB align their examination structures consistent with the proposal.

Tessera noted that the current Series 50 examination contains significant overlap with the current Series 7 examination and Municipal Advisors that have passed the Series 7 examination should not be retested on duplicative content that appears on the Series 50 examination.

Edward Jones encouraged FINRA and NASAA to consider whether the Uniform Investment Adviser Law Examination (Series 65) could be updated in conjunction with the specialized Series 7 examination so that individuals working for registered investment advisers could demonstrate the necessary knowledge required to work as a registered representative.

FINRA is currently evaluating whether the principal-level examinations could be restructured in a similar manner. FINRA has also discussed with MSRB staff the possibility of their adoption of the SIE as a concurrent requirement for the MSRB representative-level examination, the Municipal Securities Representative (Series 52) examination, as part of the restructuring, and MSRB staff participate on the SIE committee. However, FINRA notes that

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<sup>103</sup> Tessera made the same comment.

the restructuring is limited to the representative-level examinations, and it does not extend to advisory-related examinations, such as the Series 50 or Series 65 examination.

#### F. Implementation and Administration

SIFMA requested that FINRA set a fixed, maximum amount of seat time for candidates to complete the SIE plus specialized knowledge examinations. Each of the proposed examinations, including the SIE, will include a time limit, which will correlate to the number of questions on each examination. While the SIE will have a fixed time limit, the time limit on each specialized knowledge examination will vary because the number of questions on each will vary.

PFS urged that FINRA continue the practice of allowing candidates to schedule and take multiple examinations on the same day. SIFMA and ARM asked that FINRA clarify whether an individual who fails the SIE would be permitted to take a specialized knowledge examination and the applicable fees in such situations. Further, with respect to individuals who schedule the SIE and a specialized knowledge examination for the same day, FSI suggested that FINRA allow them to withdraw from taking the specialized knowledge examination without incurring a fee for the withdrawal.

An individual who fails the SIE would be allowed to take a specialized knowledge examination. This would include an individual who schedules the examinations for the same day. However, such individual's registration would not be approved in the CRD system until he or she takes and passes the examinations required for that registration category. Moreover, if such individual determines not to take a scheduled specialized knowledge examination, the

individual would be charged a fee for registering to take it.<sup>104</sup> This process is similar to the current process for registration categories that allow for concurrent qualifications, such as the Research Analyst registration category.

CFA requested that FINRA consider granting waivers to individuals who are in the process of completing an appropriate professional qualification, such as the CFA Program. In addition, CFA suggested that FINRA determine whether foreign qualifications would exempt an individual from taking a specialized knowledge examination and stated that its programs have considerable recognition in the United Kingdom and Canada. CFA also asked that FINRA consider dividing the SIE content into investment-related content and content that covers the applicable laws, rules and regulations, and it suggested that FINRA consider offering a waiver of the investment-related content to individuals who have passed a college level investments course or have made sufficient progress towards earning an appropriate professional qualification. CFA further stated that FINRA may want to consider outsourcing the development and testing of the laws, rules and regulations content on the SIE for economic reasons. Moreover, it asked that FINRA recognize the CFA's programs in granting exemptions from the restructured representative-level examinations.

Section 15A(g)(3) of the Act authorizes FINRA to prescribe standards of training, experience, and competence for persons associated with FINRA members. FINRA believes that FINRA's current process for developing examinations, which includes input from committees of industry and SRO subject matter experts, is an effective means of developing the content of FINRA examinations and consistent with FINRA's regulatory authority. Under the proposed rule change, FINRA would continue to accept requests for waivers of the applicable qualification

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<sup>104</sup> See also FINRA Rescheduling and Cancellation Policy, <http://www.finra.org/industry/reschedule-or-cancel-your-appointment>.

examinations and accept, where appropriate, other standards as evidence of an applicant's qualifications for registration.<sup>105</sup>

PFS suggested that FINRA shorten the waiting periods for retaking a failed examination and allow an individual who fails an examination to retest after seven days and allow an individual who has three successive examination failures to retest after three months. In addition, PFS asked that FINRA post and periodically update pass rate information for each examination, including the first time pass rate, overall pass rate and the success ratio. PFS also asked that FINRA delay the implementation date of the proposed rule change until the third quarter of 2017 to provide the industry adequate preparation time.

Similar to the current waiting periods for failed examinations, an individual who fails the SIE or a specialized knowledge examination would have to wait 30 calendar days before retaking that particular examination. Further, pursuant to proposed FINRA Rule 1210.06, if an individual fails the SIE or a specialized knowledge examination in three successive attempts within a two-year period, the individual would have to wait 180 days before retaking that particular examination. These waiting periods are for test security purposes and to ensure an examination's effectiveness as a measure of ability. A firm would be able to obtain a report of examination results for its associated persons and for individuals seeking to associate with the firm.

FINRA had originally proposed to implement the revised structure in two phases. The first phase would have included the SIE and the specialized knowledge examinations for the Investment Company and Variable Contracts Products Representative, the General Securities Representative and the Investment Banking Representative registration categories, which

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<sup>105</sup> For instance, as noted above, candidates are eligible for a waiver of the current Series 86 examination if they have passed Levels I and II of the CFA examination and meet other eligibility criteria. Moreover, future candidates would be eligible for similar waivers for the specialized Series 86 examination.



represent the highest volume representative-level examinations. The second phase would have included the remaining specialized knowledge examinations. As originally proposed, the first phase would have occurred in the fourth quarter of 2016, and the second phase during the first half of 2017. Rather than a phased implementation, FINRA intends to implement the entire revised structure in March 2018. FINRA believes that a single launch date in 2018 will provide greater uniformity to the implementation process and provide firms and examination applicants additional preparation time. In addition, FINRA will continue to seek industry feedback on the implementation process, and will consider extending the launch date to address any operational issues raised by the industry.

ARM requested that FINRA clarify the application process, including the applicable form(s), for individuals taking the SIE and whether they would be subject to the type of disclosures required on the Form U4 and the process by which FINRA would validate any such information. ARM further requested that FINRA publish basic guidelines or high-level requirements so that firms can better manage the expectations of associated persons seeking waivers.

Individuals taking the SIE, including associated persons of firms who are not registering as representatives, would be able to enroll for the SIE without the need to submit a Form U4, and they would not be subject to the type of disclosures required on the Form U4. FINRA is proposing to create an enrollment system that provides access through an interface in the CRD system to allow individuals who are not associated persons of a firm, including members of the general public, to enroll and pay the SIE examination fee. This system would also be available to associated persons of firms who are not required to register with FINRA. With respect to the waiver process, FINRA has published guidelines to assist firms and individuals with this process.

Moreover, FINRA will consider reaching out to the industry on the need for additional guidelines.

#### G. Examination Fees and Other Costs

ICI recommended that, to the extent practicable, the fees for the proposed examinations not exceed the fees for the current examinations. FSI noted that a high SIE fee may act as a potential barrier to entry into the securities industry. CAI also stated that the cost of the SIE cannot be prohibitive. PFS stated that candidates should not be required to pay more for examinations simply because the content will be split into separate examinations. FINRA is undertaking a pricing analysis to determine a reasonable fee for the SIE and the specialized knowledge examinations. The total examination fees for individuals registering in each representative-level category may vary depending on the fee for the SIE.

Lincoln Financial asked that FINRA evaluate the costs of additional study materials and courses resulting from having to take two examinations as well as technological changes to track the additional examination requirements. While FINRA does not have data on the costs of preparing for both the SIE and a specialized knowledge examination, FINRA believes that the proposed structure has the potential of lowering the examination preparation costs or keeping the costs the same as today, because examination applicants will be able to leverage their existing educational courses in preparing for the SIE and the specialized knowledge examinations will be shorter in length or the same length. The cost of developing and maintaining a management system to track SIE results would primarily fall upon FINRA. Further, a firm would be able to use the CRD system to track SIE results for its associated persons and for individuals seeking to associate with the firm.

FINRA specifically requested comment on the restructuring proposal's impact on the allocation of examination fees between members and examination applicants. SIFMA noted that currently some firms pay for all of their employees' examination fees and that firms that have independent contractors generally require the independent contractor to cover such fees. SIFMA added that, at this stage of the proposal, many firms do not anticipate an impact on how they allocate examination fees. CFA observed that allowing individuals who are not associated persons of firms to take the SIE would likely result in some increase in the percentage of individuals paying their own fees compared to individuals whose employers are paying their fees. N.I.S. stated that its newly-hired representatives pay the current examination fees and that the proposal would increase the cost to those representatives.

#### H. Other Comments

IMS suggested that BrokerCheck should display information on an individual's grandfathered registrations and waived examinations, and it should display the individual's professional degrees and designations on an optional basis. IMS also suggested that all regulators and auditors of FINRA members should be required to take and pass qualification examinations within a short period after they are hired, and that regulators should be allowed to hold such examinations permanently. FINRA considers these comments to be 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 up to 90 days (i) as the Commission may designate 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](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2017-007 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2017-007. 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 10:00 a.m. and 3:00 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-2017-007 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.<sup>106</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>106</sup> 17 CFR 200.30-3(a)(12).