

FINRA Proposes Changes to Personnel Registration Requirements

Introduction

On December 3, 2009, the Financial Industry Regulatory Authority (“**FINRA**”) proposed for public comment new rules (the “**Proposed Rules**”) that would govern registration and qualification requirements for persons associated with FINRA member firms.¹ The Proposed Rules will not become effective until filed with and approved by the SEC, following a second comment period.

The proposal would replace various existing National Association of Securities Dealers (“**NASD**”) and incorporated New York Stock Exchange (“**NYSE**”) Rules in the Consolidated FINRA Rulebook. The Proposed Rules would, among other things,:

- Introduce a concept of “active” and “inactive” registration of representatives and principals, and expand the range of persons not actively engaged in a member’s securities and investment banking business who may be registered through the member;
- Establish various notice and other requirements pertaining to changes in active registration status, limitations on persons having a permissive inactive registration from engaging in certain activities which require an active registration status, and define which FINRA rules apply to persons in each status;
- Clarify that most FINRA members must have two registered principals (subject to the possibility of waivers for both new and existing members);
- Provide that members engaged in investment banking must have one principal who has also satisfied the Investment Banking Representative prerequisite qualification; and members engaged in research must also have a Research Principal;
- Create a stand-alone registration category for Compliance Officers and mandate that each member must have an appropriately registered Chief Compliance Officer, as well as a Principal Financial Officer and Principal Operations Officer who are appropriately qualified as Financial and Operations Principals;
- Modify the registration categories for customer options activities, including eliminating the registration category of Options Representative and the prerequisites for registration as an Options Principal;
- Amend existing provisions pertaining to the qualifications and duties of Supervisory Analysts;
- Eliminate the Foreign Associates registration category, with a one-year grace period for qualification and registration of existing Foreign Associates; and
- Consolidate and expand registration categories and capacities.

¹ FINRA Regulatory Notice 09-70. Registration and Qualification Requirements, available at <http://www.finra.org/Industry/Regulation/Notices/2009/P120490> (the “Regulatory Notice”). This proposal is part of FINRA’s rulebook consolidation process, which seeks to harmonize and consolidate the rules of the National Association of Securities Dealers (“NASD”) and the New York Stock Exchange (“NYSE”).

Active, Inactive and Permissive Registration

Proposed Rule 1210 expressly differentiates between active and inactive registration status and integrates the provisions regarding required and permissive registration.

Active Registration

Proposed Rule 1210(a) would consolidate NASD Rules that require registration as representatives or principals persons engaged in the investment banking or securities business of a member, and in the management of such activities, and would prohibit registered persons from functioning in a registered capacity for which they are not registered. Under the proposal, FINRA will presume that a registration is active unless it is notified otherwise.²

Permissive Inactive Registration- Bona Fide Business Purpose Functions

Current rules allow member firms to register and maintain registration of principals and representatives who perform legal, compliance, internal audit, and back office operations. Proposed Rule 1210(b) would expand permissive registration to allow a member to register any associated person who is engaged in a “bona fide business purpose” of the member.

An associated person with inactive permissive registration status will need to notify FINRA and will only be required to satisfy certain of the requirements of associated persons.³ Member firms will need to distinguish between functions that require active registration and functions that allow inactive registration for purposes of complying with this notice requirement. Associated persons who are currently registered permissively based on their job responsibilities would have to become registered under the new permissive bona fide business purpose registration.

Permissive Inactive Registration- Retained Associate

Proposed Rule 1210(c) would expand the current rules that allow a member to register or maintain the registration of an associated person who is engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary, to include any individual who is engaged in the business of any financial services industry affiliate of the member.

As with the bona fide business purpose permissive registration, an individual would be obligated to notify FINRA of the inactive registration status. Proposed Rule 1210(c)(2) would allow an individual to be designated as a Retained Associate for ten consecutive years, starting on the date the person is initially designated, with complex provisions that provide for tolling (and, in some cases, forfeiture) of the ten year time period. A Retained Associate would not be considered a registered or an associated person, and would only be subject to certain FINRA requirements.⁴ Notice would be required upon the registration, change or termination of Retained Associate status.

Two Principal Requirement

Proposed Rule 1210(e) would provide that a member is required to have a minimum of two principals that are registered as General Securities Principal with special provisions for firms with only one associated person and firms whose business is limited to investment company and variable contracts products or

² Special rules apply in the case of persons who are called into active duty in the armed forces or who return from such duty.

³ These include FINRA's by-laws and rules concerning fees and charges, Forms U4 and U5; registration, continuing education, supervision (to a limited extent), annual compliance meeting participation; and personnel background investigations.

⁴ These include FINRA's by-laws and rules concerning fees and charges, Forms U4 and U5, registration, filing of misleading information, supervision (to a limited extent), continuing education; annual compliance meeting participation, personnel background investigations, personal securities transactions, reporting requirements, new issues of securities of member affiliate securities, and investigations, sanctions and disciplinary measures. Persons subject to a “statutory disqualification” may not have a Retained Associate status.

direct participation products. FINRA can waive the two principal requirement in the case of sole proprietors or small member firms, if the circumstances warrant that only one person be required to register as a principal. In general, persons seeking registration as General Securities Principals must, prior to or concurrent with such registration, be registered as a General Securities Representative.

Required Designations

Each member firm will be required to have a registered Chief Compliance Officer, a Financial and Operations Principal (or, for introducing firms, an Introducing Broker-dealer Financial and Operations Principal) and must designate qualified persons as a Principal Financial Officer and Principal Operations Officer. A member who engages in certain investment banking activities must have a General Securities Principal that has satisfied the Investment Banking Representative requirement, and a member who engages in research activities must have a Research Principal.⁵

Impermissible Registrations

Proposed Rule 1210(g) would replace the existing provisions prohibiting “parking” of registrations and prohibit members from registering any individual unless such person is in one of the permissible registration categories. The Proposed Rule contains precise and extensive requirements concerning which registrations are required for what specific types of activities.

Qualification Examination Requirements

Proposed Rule 1220 would consolidate the existing provisions requiring qualification examinations and addressing waivers. Similarly, proposed rule 1220(f) consolidates the provisions that require re-testing if a registration was terminated more than two years ago, absent a waiver.

Proposed Rule 1220(g) would amend current rules which allow a member to designate a representative to act as a principal, by adding the additional requirement that the representative’s registration status be active for at least 18 months of the immediately preceding five years. In addition, the representative must have fulfilled all of the prerequisite registration, fee and examination requirements prior to designation as principal and will be given 120 days to pass the applicable principal qualification exam. A representative is prohibited from acting as principal after 120 days if the representative has not passed the principal examination.

Registration Categories

Proposed Rule 1230 integrates the various registration categories into one rule, which specifies the requirements, prerequisites and/or limitations of each specific registration category for principals and representatives.

Principal - General Definition and Principal Registration Categories

Proposed Rule 1230(a) would clarify the general definition of principal and the specific categories that are included in that definition and would clarify the requirements, prerequisites and limitations of each category of principal.

The Proposed Rules incorporate existing guidance on what constitutes “actively engaged in the management of the member’s investment banking or securities business” and state that it includes the implementation of corporate policies, managerial decision-making authority, and management-level supervisory responsibilities (*i.e.*, voting member of the member’s executive, management or operations committee). The Proposed Rules also state that any associated person who is performing functions that

⁵ New prerequisites will apply to research principal qualifications, but there is a grandfathering provision for existing registered Research Principals.

are required to be performed by a principal under the FINRA Rules, and a member's CEO and CFO and equivalent officers are automatically considered principals.

The most significant changes in the Proposed Rules regarding registration as a principal include:

- Moving Chief Compliance Officers and Research Principals to stand alone registration categories;
- Requiring anyone designated on Form BD as Chief Compliance Officer to be registered as Chief Compliance Officer and pass the Compliance Official examination (a current NYSE requirement) before registration is effective.⁶
- Clarifying that an individual registered solely as a General Securities Principal is not qualified to function as a Research Principal, Principal Financial Officer or Principal Operations Officer;
- Eliminating the Options Representative category and therefore eliminating from the Options Principal category the Options Representative prerequisite. A person registered as an Options Principal prior to the effective date of the rule will be grandfathered from the new prerequisite requirement;
- Creating a stand alone permissive registration category for Supervisory Analysts. An individual whose activities are limited to approving research reports may register as a Supervisory Analyst provided the person passes the Supervisory Analyst exam and is supervised by a Research Principal. The Proposed Rules also eliminate the provision of the NYSE rules that require evidence of appropriate experience; and
- Adding "approval of customer accounts" to the list of permissible supervisory activities of a General Securities Sales Supervisors and removing the restriction from providing final approval of advertisements.

Representative - Definition and Representative Registration Categories

Proposed Rule 1230(b)(1) defines representative and clarifies the requirements and applicable exceptions and examination waivers of each category of representative.⁷

The most significant proposed changes include:

- Adopting the NYSE registration requirement for Securities Lending Representatives and Securities Lending Supervisors;
- Clarifying that a person whose sole function is to accept unsolicited customer orders is permitted, but not required, to register as an Order Processing Assistant Representative;
- Eliminating the Options Representative category and instead requiring that a representative engaged in options activity register as a General, UK, or Canada Securities Representative. Any individual who is already registered as an Options Representative immediately prior to the effective date of this rule will be grandfathered from this requirement; and

⁶ There are a number of exceptions from the requirement to allow for a smooth transition to the new exam requirement, including a limited grandfathering provision for persons already designated as Chief Compliance Officers, and an exception for persons who have earned a FINRA Institute at Wharton Certified Regulatory and Compliance Professional designation.

⁷ The categories of representatives include: General Securities Representative; Research Analyst; Equity Trader; Investment Banking Representative; Securities Lending Representative and Supervisor; Order Processing Assistant Representative; and Proctors of In-Firm Delivery and Regulatory Element; Investment Company and Variable Contracts Products Representative; Direct Participation Programs Representative; Corporate Securities Representative; Government Securities Representative; and Private Securities Offering Representative.

- Eliminating the Foreign Associates registration category and requiring anyone who is registered as a Foreign Associate to fulfill prerequisites and register in an appropriate category within a year of the effective date of the Proposed Rules.

Associated Persons Exempt from Registration

FINRA has proposed to transfer with non-substantive changes, the existing rules regarding exemption from registration with a few notable exceptions discussed below.

Unsolicited Customer Orders

FINRA has proposed to rescind the guidance that allows unregistered persons (generally administrative personnel) to accept unsolicited customer orders. According to the Regulatory Notice, FINRA believes that accepting customer orders is not a clerical or ministerial function and associated persons who accept orders should be properly registered.

Unregistered Personnel

FINRA has proposed to amend and clarify the current exemption for associated persons whose functions are related exclusively to effecting transactions on the floor of a national securities exchange. The Proposed Rules would amend this exemption to allow it to apply to associated persons if they are registered with the exchange as a floor member or in another appropriate registration category.

Conclusion

Although the Proposed Rules will not revolutionize the general structure of personnel registration or qualification criteria, they will require fairly substantial changes in registration practices and procedures. Firms should carefully consider whether the proposed changes will impose burdens to their personnel and registration processes that are not justified by regulatory benefits. FINRA requests comments on the proposal by February 1, 2010.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact

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