

VOICE OF INDEPENDENT BROKER-DEALERS AND INDEPENDENT FINANCIAL ADVISORS

www.financialservices.org

VIA ELECTRONIC MAIL

July 30, 2010

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Regulatory Notice 10-25 - Proposed Registration Category, Qualification Examination and Continuing Education Requirements for Operations Professionals

Dear Ms. Asquith:

On May 26, 2010, the Financial Industry Regulatory Authority, Inc. (FINRA) published Regulatory Notice $10\text{-}25^1$ (RN 10-25) seeking comment on its proposal to expand FINRA's registration requirements to include individuals who are engaged in, or supervising, activities relating to sales and trading support, and that handle customer assets. FINRA indicates that it has concerns about the potential for regulatory gaps in the licensing and educational requirements for individuals performing "back office" operations functions at member broker-dealers. Proposed FINRA Rule 1230(b)(6)(A-E) (Proposed Rule) sets out the new categories of personnel subject to registration, the job functions that are included in the new registration categories, a description of the qualification examination that these individuals will be required to take, the exemptions to the examination requirement, the continuing education requirements for this new operations category of registration, and the time frame for implementation of the Proposed Rule's requirements.

The Financial Services Institute (FSI)² welcomes this opportunity to comment on the Proposed Rule. We support the spirit of the Proposed Rule because we believe investor protection will be enhanced by providing additional training and education to individuals who supervise broker-dealer operations. However, it is our opinion that the objectives laid out in the Proposed Rule can be achieved with a less expansive and expensive approach. Specifically, we urge FINRA to drop the testing component of the Proposed Rule. In addition, we ask that FINRA narrow the breadth of the covered functions through well-crafted definitions of their terms. We also ask that the Proposed Rule address functions shared by introducing broker-dealers and their clearing firms. Finally, we urge FINRA to expand the implementation period set forth in the Proposed Rule to allow a more reasonable period of time for firms and supervisors to achieve compliance. These concerns are discussed more fully in this letter.

Background on FSI Members

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

¹ Regulatory Notice 10-25, Registration and Qualification Requirements for Certain Operations Personnel, available at http://www.finra.org/web/groups/industry/@ip/@req/@notice/documents/notices/p121533.pdf.

² The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 122 Broker-Dealer member firms that have more than 188,000 affiliated registered representatives serving more than 15 million American households. FSI also has more than 14,500 Financial Advisor members.

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

In the U.S., approximately 180,000 financial advisors – or approximately 61.7% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.³ These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence. Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

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

Comments on the Proposed Rule

As stated above, FSI supports the spirit of the Proposed Rule because we believe investor protection will be enhanced by providing additional training and education to individuals who supervise broker-dealer operations. However, it is our opinion that the objectives laid out in the Proposed Rule can be achieved with a less expansive and expensive approach. Specifically, we urge FINRA to drop the testing component of the Proposed Rule. In addition, we ask that FINRA narrow the breadth of the covered functions through well-crafted definitions of their terms. We also ask that the Proposed Rule address functions shared by introducing broker-dealers and their clearing firms. Finally, we urge FINRA to expand the implementation period set forth in the Proposed Rule to allow a more reasonable period of time for firms and supervisors to achieve compliance. We believe the Proposed Rule could be improved substantially by addressing the concerns we raise below:

³ Cerulli Associates at http://www.cerulli.com/.

⁴ These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.

• Testing Component — RN 10-25 indicates that the examination contemplated for Operations Professionals is not intended to be a competency exam.⁵ RN 10-25 provides that the examination "would test for general securities industry knowledge with a regulatory focus to alert such persons that they are functioning in a heavily regulated industry." More specifically, RN 10-25 indicates that, "FINRA proposes the development of a single principles-based qualification examination with a regulatory focus to test for a broad understanding of a broker-dealer's business at a basic level; a basic understanding of the operations functions that support a broker dealer's business; and the regulations designed to achieve investor protection and market integrity that drive the operations processes and procedures conducted at a broker-dealer."

We believe that FINRA can achieve the end result of ensuring that individuals who supervise, manage, and have discretion to commit the capital of firms understand that they are working in and are functioning in a heavily regulated industry simply by: 1) addressing supervision of the Covered Functions in Written Supervisory Procedures (WSPs); and 2) through mandatory firm element training. We believe well designed WSPs and firm element training can "test for general securities industry knowledge with a regulatory focus to alert such persons that they are functioning in a heavily regulated industry." Since the examination requirement is unnecessary to achieve the purposes of the Proposed Rule we urge FINRA to remove subsection (C) from Proposed FINRA Rule 1230(b)(6).

Alternatively, if is determined that an examination is desirable, we believe there should be a grandfathering provision for individuals who have worked in the operations areas of a broker-dealer prior to the implementation of the testing and registration requirements. We suggest that FINRA use the grandfathering provisions contemplated for Chief Compliance Officers in Regulatory Notice 09-70 as a guide in developing this provision. While we are aware that individuals that have worked as operations professionals in the past may not have been required to register with FINRA, we see merit in exempting experienced operations professionals who have been in that capacity, or a similar capacity, for the past five (5) or more years. We suggest the following language be inserted in subsection (D) of Proposed FINRA Rule 1230(b)(6):

A person who is required to register pursuant to FINRA Rule 1230(b)(6), but has acted in the capacity of a Covered Person as defined under FINRA Rule 1230(b)(6)(B) for the preceding five years prior to the effective date of the FINRA Rule 1230(b)(6)(C), will be not be required to sit for the examination pursuant to FINRA Rule 1230(b)(6)(C).

Covered Functions – FSI is concerned that the Covered Functions are written too broadly, will cover too many individuals within the firm and are poorly tailored to meet the objectives of the Proposed Rule. These concerns arise from apparent ambiguity in the description of the covered functions in the Proposed Rule. Specifically, we believe there would be greater clarity if FINRA were to define some of the terms in Proposed FINRA Rule 1230(b)(6)(B)(vi) and (vii).

⁵ Regulatory Notice 10-25, Registration and Qualification Requirements for Certain Operations Personnel, at 5.

⁶ *ld*.

O Proposed FINRA Rule 1230(b)(6)(B)(vi) — This subsection of the Proposed Rule provides that the following action is a Covered Function for the purposes of this Proposed Rule; "[c]apturing of business requirements for sales and trading systems and any other systems related to the covered functions, and validation that these systems meet such business requirements."

In reading the aforementioned Covered Function, it is unclear where to start and stop when applying this function. It is not clear if it applies to individuals who enter suitability information into systems ("[c]apturing of business requirements for sales") or if it applies more generally to all data entry positions. We believe, that this ambiguity will lead to inconsistent application and could cause firm to register operations professionals who are not the target of this Proposed Rule. We urge FINRA to better define what "capturing of business requirements for sales" means for the purposes of the Proposed Rule.

Proposed FINRA Rule 1230(b)(6)(B)(vii) — This subsection of the Proposed Rule provides that the following action is a Covered Function for the purposed of this Proposed Rule; "[w]ith respect to the covered functions, defining and approving business security requirements and policies for information technology (including, but not limited to, systems and data).

In applying this section of the Proposed Rule, we are not certain if this applies to individuals who communicate information to individuals who work in the Information Technology (IT) department on the scope and requirements of a system, if it applies to the individuals who develop the information technology systems, or if there is another interpretation that FINRA has in mind. It is our opinion that applying this covered function in broad application could sweep in virtually all individuals who work in a firm's IT department. We urge FINRA to better define the scope and application of this subsection of the Proposed Rule.

Shared Functions – Many independent broker-dealers operate as fully disclosed introducing broker-dealer firms. These firms often share responsibility for operational business functions with their clearing firm(s). Introducing broker-dealers and their respective clearing firms are required to enter in to a Clearing Agreement pursuant to NASD Rule 3230.8 The Clearing Agreement sets out minimum obligations and responsibilities between the two parties.

We reviewed the list of fifteen covered functions and determined that many describe activities may be the responsibility of both the introducing and clearing broker-dealer. These shared functions include:

margin; prime brokerage; collection, maintenance, re-investment (*i.e.,* sweeps), and disbursement of funds; bank, custody, depository and firm account management and reconciliation.

It is not clear in the Proposed Rule if an individual at the introducing broker-dealer or an individual at the clearing firm would be required to take the operations examination for shared functions. Where these situations exist, we believe it will prove difficult for

⁸ NASD Conduct Rule 3230 — Clearing Agreements, available at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4428&element_id=3750&highlight=clearing+firm#r4428

introducing broker-dealers and clearing firms to determine which operations personnel have to register and take the operations examination. In an attempt to resolve this ambiguity, we suggest FINRA amend NASD Rule 3230 to require the parties to a Clearing Agreement clearly designate who is responsible for any shared functions.

• Ancillary Functions – Page three of Regulatory Notice 10-25 provides that the requirements of the Proposed Rule would not apply to "persons who perform 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, such as internal audit, legal or compliance personnel." The Regulatory Notice also provides that "the requirements [of the rule] would not apply to persons who are engaged solely in clerical or ministerial activities in any of the covered functions." However, the language of the Proposed Rule does not include this language. We request that FINRA incorporate this important limitation in the text of the Proposed Rule. Below you will find language to accomplish this goal:

Proposed FINRA Rule 1230(b)(6)(D) — Any persons who perform 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, such as internal audit, legal or compliance personnel is not required to take the Operations Professional Examination or register as a Operations Professional. The requirements of this rule do not extend to clerical or ministerial activities in any of the covered functions.

• Implementation Period — We believe that the six- to nine- months implementation period provided for in the Proposed Rule is insufficient time to comply with the requirements of the Proposed Rule. Firms will have to go through the following lengthy exercise in order to determine who is subject to and who must take the qualification examinations. These employees will then have to become registered with FINRA and take the exam. This process includes the following steps: 1) identifying who is impacted by this Rule Proposal; 2) providing notice to the individuals impacted; 3) completing a Form U4; 4) the firm will have to open a testing window; 5) the individual must schedule a date to take the Operations Professional examination; 6) the individual must study and prepare for the examination (including a exam preparation class if they feel necessary); 7) the individual must sit for the test; 8) the individual must re-test if necessary; and 9) possibly the individual must re-test again. Given the contemplated lengthy process, we believe that twelve - eighteen months would an adequate timeframe to accomplish these objectives.

⁹ *Id. at 3.*

Conclusion

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

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

Respectfully submitted,

Sincerely,

David T. Bellaire, Esq.

General Counsel and Director of Government Affairs