

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-64687; File No. SR-FINRA-2011-013]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Establishing a Registration Category, Qualification Examination and Continuing Education Requirements for Certain Operations Personnel, and Adopt FINRA Rule 1250 (Continuing Education Requirements) in the Consolidated FINRA Rulebook

June 16, 2011.

#### I. Introduction

On March 4, 2011, the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission"), 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> a proposed rule change to adopt FINRA Rule 1230(b)(6) to establish a registration category and qualification examination requirement for certain operations personnel. The proposed rule change also would adopt continuing education requirements for such operations personnel and adopt NASD Rule 1120 (Continuing Education Requirements) as FINRA Rule 1250 (Continuing Education Requirements) in the consolidated FINRA rulebook with minor changes. The proposed rule change was published for comment in the **Federal Register** on March 18, 2011.<sup>3</sup> The Commission received seventeen comment letters on the proposed rule change.<sup>4</sup> On June 15,

2011, the Commission received from FINRA a Response to Comments and Partial Amendment No. 1 to the proposed rule change.<sup>5</sup> The Commission is publishing this notice and order to solicit comment on Amendment No. 1 and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

#### II. Description of Proposed Rule Change and Summary of Comments

As described in Exchange Act Release No. 64080,<sup>6</sup> FINRA is proposing to adopt FINRA Rule 1230(b)(6) to establish a registration category and qualification examination requirement for certain operations personnel. The proposed rule change also would adopt continuing education requirements for such operations personnel and adopt NASD Rule 1120 (Continuing Education Requirements) as FINRA Rule 1250 (Continuing Education Requirements) in the consolidated FINRA rulebook with minor changes. All of the commenters opposed the rule in whole or in part.

FINRA's responses to comments and explanation of the changes to the proposed rule change made by Amendment No. 1 are described below.

##### A. Covered Persons

Proposed FINRA Rule 1230(b)(6)(A) sets forth three categories of persons that would be subject to the proposed registration, qualification and continuing education requirements for an Operations Professional.<sup>7</sup> These categories are:

("FSI"); Joan Hinchman, Executive Director, CEO and President, National Society of Compliance Professionals Inc., dated April 8, 2011 ("NSCP"); Ronald C. Long, Director of Regulatory Affairs, Wells Fargo Advisors, LLC, dated April 8, 2011 ("WFA"); Bari Havlik, SVP and Chief Compliance Officer, Charles Schwab & Co., Inc., dated April 8, 2011 ("Schwab"); Sutherland Asbill & Brennan LLP, on behalf of the Committee of Annuity Insurers, dated April 8, 2011 ("Sutherland"); Jesse D. Hill, Director of Regulatory Relations, Edward Jones, dated April 8, 2011 ("Edward Jones"); James T. McHale, Managing Director and Associate General Counsel, SIFMA, dated April 29, 2011 ("SIFMA"); David S. Massey, President, North American Securities Administrators Association, dated May 2, 2011 ("NASAA"); John W. Curtis, Managing Director, General Counsel—Global Compliance, Goldman, Sachs & Co., dated May 3, 2011 ("Goldman"); and Pam Lewis Marlborough, Associate General Counsel, TIAA-CREF Individual & Institutional Services, LLC, dated May 4, 2011 ("T-C Services—2").

<sup>5</sup> See letter from Erika A. Lazar, FINRA, to Elizabeth Murphy, Secretary, SEC, dated June 15, 2011 ("Response Letter"). The text of the proposed rule Amendment No. 1 and FINRA's Response Letter are available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA, on the Commission's Web site at <http://www.sec.gov>, and at the Commission's Public Reference Room.

<sup>6</sup> See note 3 *supra*.

<sup>7</sup> See Notice, note 3 *supra*.

(1) Senior management with responsibility over the covered functions;<sup>8</sup>

(2) Supervisors, managers or other persons responsible for approving or authorizing work, including work of other persons, in direct furtherance of the covered functions; and

(3) Persons with the authority or discretion materially to commit a member's capital in direct furtherance of the covered functions or to commit a member to any material contract or agreement (written or oral) in direct furtherance of the covered functions.

One commenter supports limiting the scope of covered persons to supervisory personnel.<sup>9</sup> Three commenters are concerned about the impact of the proposed rule change on arrangements between members and third-party service providers, and request that FINRA limit the proposal to "associated persons" of a member.<sup>10</sup> One such commenter requests an analysis of FINRA rules, the Securities Exchange Act of 1934 ("Exchange Act") and SEC rules to allay concerns of unexpected or unintended applications, interpretations and consequences with respect to sweeping employees of third-party service providers into the categories of associated and registered persons.<sup>11</sup>

Another commenter states that limiting the proposal to associated persons would assist members in interpreting the proposed rule and resolve complicated jurisdictional and practical issues, since requiring firms to license employees of third-parties raises many complex issues including contract negotiations with vendors determining which member firm should sponsor the registrations of a vendor's employees and which firm should "supervise" such employees when a single vendor serves multiple members.<sup>12</sup> Additionally, the commenter suggests changing the title of proposed Rule 1230(b)(6)(A) from "Requirement" to "Covered Persons" and limiting this provision to the following: "[e]ach of the following associated persons of a member, charged with responsibility for overseeing and protecting the functional and control integrity of the covered functions in paragraph (b)(6)(B) of this Rule, shall be required to register as an Operations Professional."<sup>13</sup> The commenter notes that this language, in part, mirrors descriptive language used

<sup>8</sup> Covered functions are discussed further in Part B below.

<sup>9</sup> TLG.

<sup>10</sup> NSCP, Schwab and SIFMA.

<sup>11</sup> Schwab.

<sup>12</sup> SIFMA.

<sup>13</sup> SIFMA.

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

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

<sup>3</sup> See Securities Exchange Act Release No. 64080 (March 14, 2011), 76 FR 15012 (March 18, 2011) ("Notice").

<sup>4</sup> See comment letters submitted by Corey N. Callaway, CEO, Callaway Financial Services, Inc., dated March 22, 2011 ("Callaway"); Jeffrey B. Williams, Vice President & Chief Compliance Officer, Northwestern Mutual Investment Services, LLC, dated March 25, 2011 ("NMIS"); Z. Jane Riley, Chief Compliance Officer, The Leaders Group, Inc./TLG Advisors, Inc., dated April 6, 2011 ("TLG"); Matthew J. Gavaghan, Associate General Counsel, Janney Montgomery Scott LLC, dated April 8, 2011 ("JMS"); Pam Lewis Marlborough, Associate General Counsel, TIAA-CREF Individual & Institutional Services, LLC, dated April 8, 2011 ("T-C Services—1"); James Livingston, President/Chief Executive Officer, National Planning Holdings, Inc., dated April 8, 2011 ("NPH"); D. Grant Vingoe, Partner, Arnold & Porter LLP, dated April 8, 2011 ("A&P"); David T. Bellaire, General Counsel and Director of Government Affairs, Financial Services Institute, dated April 8, 2011

by FINRA in the Notice. The commenter believes that the proposed rule change significantly expands FINRA's regulation of outsourced activities and requests that such authority be addressed as part of FINRA's outsourcing proposal.<sup>14</sup> Another commenter requests that FINRA limit covered persons to employees of a member, given that the current proposal would result in a great deal of subjectivity by members to identify covered persons, and in light of a member's supervisory obligations for outsourced functions under current FINRA guidance.<sup>15</sup>

FINRA responded that, as stated in the Notice, it believes that any person who meets the definition of a covered person in proposed Rule 1230(b)(6)(A) and engages in one or more of the covered functions in proposed Rule 1230(b)(6)(B) on behalf of a member must register as an Operations Professional, regardless of whether such person works internally at a member, an affiliate or third-party service provider because they are performing regulated broker-dealer functions on behalf of a member.<sup>16</sup> FINRA believes that covered persons interact in areas of a member that have a meaningful connection to client funds, accounts and transactions and are involved in significant decisions that can raise compliance issues for a firm.<sup>17</sup> Also, FINRA states that, as noted in the Notice, the proposed rule change does not alter the definition of an associated person; rather, it imposes registration, qualification examination and continuing education requirements on persons who meet the depth of personnel criteria and engage in one or more of the covered functions on behalf of a member.<sup>18</sup>

In its Response Letter, FINRA stated that the alternative rule text suggested by the commenter above<sup>19</sup> would not change the application of the proposed rule because, by virtue of their activities on behalf of the member, the covered persons have been and continue to be associated persons of such member.<sup>20</sup> FINRA stated that Associated person status is not determined at the discretion of a member firm based on the location from which particular personnel are performing functions on behalf of the firm; associated person status attaches to persons who are involved in the securities and

investment banking business of a member firm and the covered functions in the proposed rule represent a part of that business of a member firm.<sup>21</sup> Moreover, FINRA notes that the scope of covered persons and covered functions set forth in proposed Rule 1230(b) is not exhaustive in terms of who may be considered an associated person of the member based on the nature of the operations activities being conducted on behalf of a member.<sup>22</sup> Rather, FINRA has made a determination that the persons subject to the proposed rule change are engaged in members' operations activities of such significance to require registration, qualification examination and continuing education requirements.<sup>23</sup> FINRA, however, notes that it is proposing to amend the title of paragraph (b)(6)(A) to proposed Rule 1230 to "Covered Persons" from "Requirement" to better reflect the content of the paragraph.<sup>24</sup>

Two commenters note the prevalence of shared resources models, in which shared services are provided to different legal entities within a large financial company, and the challenges raised by the proposed rule for firms in determining whether certain individuals previously not identified as associated persons would now be subject to the rules applicable to associated and registered persons.<sup>25</sup> One commenter requests clarification that only the Operations Professional and not his or her supervisors or subordinates would be considered associated persons of the member.<sup>26</sup> The commenter also suggests that FINRA's jurisdiction should not extend to any of the affiliated entities that may employ an Operations Professional.<sup>27</sup>

FINRA responds that members are free to use shared services models because associated person status does not turn on employment.<sup>28</sup> FINRA notes that the proposed rule does not define associated persons; rather, it defines which associated persons involved in the operation of a member's investment banking and securities business must register as an Operations Professional.<sup>29</sup> FINRA says that firms must view each person's responsibilities in connection with the covered functions independently to determine who must register.<sup>30</sup>

One commenter believes the proposed rule change is unfairly burdensome on small firms, since it will make it impossible to obtain and retain employees, in particular the potential registration of independent Information Technology ("IT") personnel and other similarly outsourced functions.<sup>31</sup> Another commenter states that rather than requiring individuals at both the introducing broker-dealer and clearing firm to register and test under the proposed rule, FINRA should amend FINRA Rule 4311 (Carrying Agreements) to require that parties to a clearing agreement specifically designate the party responsible for any shared functions in the clearing agreement to reduce the economic and resource burden of requiring all individuals who meet the criteria of a covered function to register under the proposal.<sup>32</sup>

As further discussed in the Notice, FINRA does not believe that small firms would be overly burdened by the proposed rule change.<sup>33</sup> FINRA anticipates that many persons who would be subject to the new Operations Professional registration category would qualify for the proposed exception from the qualification examination based on existing registrations, and FINRA would not assess a separate registration fee for persons relying on the proposed exception to register as Operations Professionals.<sup>34</sup> FINRA says, moreover, that the impact of the proposed rule change is expected to be minimal as the majority of the covered functions are typically performed by a carrying and clearing firm pursuant to a clearing arrangement.<sup>35</sup> In such cases, it may be possible for a small firm to rely on limited persons, perhaps the Financial and Operations Principal, to liaise with the carrying and clearing firm regarding those covered functions. FINRA stated that, as further discussed in the Notice, a covered person would not be considered an associated person of both the introducing and clearing firms based solely on functions performed pursuant to a carrying agreement approved under FINRA Rule 4311 (Carrying Agreements).<sup>36</sup> FINRA indicated that it would not expect dual registration as an Operations Professional in such cases.<sup>37</sup>

<sup>31</sup> Callaway.

<sup>32</sup> FSI. The SEC recently approved new FINRA Rule 4311. See Exchange Act Release No. 63999 (Mar. 1, 2011), 76 FR 12380 (Mar. 7, 2011). The rule becomes effective on August 1, 2011. See *Regulatory Notice* 11-26.

<sup>33</sup> Response Letter.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> NPH and Sutherland.

<sup>26</sup> Sutherland.

<sup>27</sup> Sutherland.

<sup>28</sup> Response Letter.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>14</sup> SIFMA. See also *Regulatory Notice* 11-14 (Third-Party Service Providers).

<sup>15</sup> NSCP.

<sup>16</sup> Response Letter.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> See *supra* note 13 and accompanying text.

<sup>20</sup> Response Letter.

In addition, as further discussed in Section F below, the proposed rule change provides a 120-day grace period for non-Day-One Professionals associated with a non-clearing firm to pass a qualification examination.<sup>38</sup>

One commenter believes that the depth of personnel and covered functions are so loosely worded as to potentially capture activities performed in a number of areas of a member firm, including, but not limited to, Operations, Finance, Treasury, Information Technology (“IT”), Information Security (“IS”), Marketing and Sales.<sup>39</sup> FINRA agrees with the commenter that covered persons may be designated in multiple areas of a member (or outside the member) depending on the business structure of the firm.<sup>40</sup> FINRA stated that the proposed rule change is function-based and, therefore, not conditioned upon an individual’s relationship to a particular department within a firm.<sup>41</sup> FINRA said that, in developing the proposed rule change and with the input of industry representatives, they identified operations functions that significantly impact a member’s business and have the potential to harm the member, a customer, the integrity of the marketplace or the public.<sup>42</sup>

Several commenters have concerns regarding the application of proposed Rule 1230(b)(6)(A)(i) (“[s]enior management with responsibility over the covered functions”) to senior management up the chain of command. One commenter questions how far up the chain of command this provision is intended to go (*i.e.*, whether it is intended to reach the CEO) and recommends limiting it to persons with “direct” or “primary” responsibility for the covered functions.<sup>43</sup> The commenter requests express guidance that a firm’s Chief Information Officer, Chief Technology Officer or other senior executives responsible for a firm’s overall IT function would not be required to register if not directly or primarily responsible for a covered function.<sup>44</sup> Another commenter suggests the proposed rule be limited to “senior management directly responsible for supervising or overseeing the covered functions to ensure integrity and compliance with the Federal securities laws and regulations and FINRA

rules.”<sup>45</sup> The commenter notes that a firm’s Chief Technology Officer and other technology or information security executives may be deemed senior management responsible for a covered function, even though their roles are supportive in nature, and other executives who hold other licenses would also be required to register (*i.e.*, Marketing and Sales executives who design customer confirms or assist in customer data collection at account opening).<sup>46</sup> The commenter posits that if these executives are required to register, individuals down the chain of command would also be subject to the proposal, which the commenter finds unnecessary and redundant.<sup>47</sup> The commenter also requests that the SEC not approve the proposed rule change unless FINRA limits covered persons to those individuals with “significant responsibilities or substantial decision-making authority regarding operational issues.”<sup>48</sup>

To clarify proposed Rule 1230(b)(6)(A)(i), FINRA is amending the proposed rule change to provide that the first category of covered persons would include senior management with *direct* responsibility over the covered functions.<sup>49</sup> FINRA states that it believes this proposed change will better enable members to identify who must register as an Operations Professional so that senior management with an indirect relationship to the covered functions are not subject to the proposed registration, qualification examination and continuing education requirements; however, members must ensure senior management that sign off on the covered functions and who are responsible for ensuring the covered functions are executed in compliance with the Federal securities laws and regulations and FINRA rules are properly registered.<sup>50</sup> FINRA states that the proposal’s aim is not to require registration for personnel with an indirect connection to the covered functions.<sup>51</sup>

One commenter suggests that proposed Rule 1230(b)(6)(A)(ii) (“[s]upervisors, managers or other persons responsible for approving or

authorizing work, including work of other persons, in direct furtherance of the covered functions”) is too broad and may include employees below the decision-making level and further suggests replacing this provision with language in the Notice: “[p]ersons who are directly responsible for overseeing that tasks within the covered functions are performed correctly in accordance with industry rules, firm protocols, policies and procedures, and who are charged with protecting the functional and control integrity of the covered functions for a member.”<sup>52</sup> The commenter believes that this language also would make proposed Rule 1230(b)(6)(A)(iii) unnecessary.<sup>53</sup>

To clarify proposed Rule 1230(b)(6)(A)(ii), FINRA is proposing to amend the proposed rule to provide that the second category of covered persons would include any person designated by senior management specified in Rule 1230(b)(6)(A)(i) as a supervisor, manager or other person responsible for approving or authorizing work, including work of other persons, in direct furtherance of each of the covered functions, as applicable, provided that there is sufficient designation of such persons by senior management to address each of the applicable covered functions.<sup>54</sup> FINRA believes the change to proposed Rule 1230(b)(6)(A)(ii) helps to clarify that senior management of a firm may designate the next tier of management or other persons responsible for approving or authorizing work in direct furtherance of the covered functions, in accordance with reasonable business practices.<sup>55</sup> In addition, FINRA stated that any person who qualifies as a covered person is responsible for ensuring that the covered functions are performed correctly in accordance with industry rules, firm protocols, policies and procedures by virtue of their position.<sup>56</sup> FINRA stated that it believes this concept, as introduced by FINRA in the Notice to elaborate generally on the role of covered persons, is implicit in each of the three categories of covered persons in proposed Rule 1230(b)(6)(A)(i) through (iii).<sup>57</sup>

One commenter requests that proposed Rule 1230(b)(6)(A)(iii) (“[p]ersons with the authority or discretion materially to commit a member’s capital in direct furtherance of the covered functions or to commit a

<sup>38</sup> *Id.*

<sup>39</sup> T-C Services—1.

<sup>40</sup> Response Letter.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> SIFMA.

<sup>44</sup> SIFMA.

<sup>45</sup> T-C Services—1.

<sup>46</sup> T-C Services—1.

<sup>47</sup> T-C Services—1.

<sup>48</sup> T-C Services—2 (referencing remarks made by Richard Ketchum, Chairman and CEO of FINRA).

<sup>49</sup> Response Letter.

<sup>50</sup> *Id.*

<sup>51</sup> See also proposed FINRA Rule 1230.06 (Scope of Operations Professional Requirement) (excluding from registration those persons 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).

<sup>52</sup> WFA.

<sup>53</sup> WFA.

<sup>54</sup> Response Letter.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

member to any material contract or agreement (written or oral) in direct furtherance of the covered functions”) be amended to state that only written contracts are within its scope to avoid confusion arising from interpreting when an oral contract may arise in the context of back-office operations.<sup>58</sup> FINRA stated that it does not intend to amend the proposal as suggested by the commenter.<sup>59</sup> FINRA said the parenthetical language that makes express that both written and oral contracts are included in the proposed rule derives from NYSE Rule 345.10 in the definition of a “securities lending representative.”<sup>60</sup> FINRA stated that it believes that any contract or agreement, written or oral, that materially commits a member in direct furtherance of the covered functions (not just in the context of a securities lending arrangement) is of a nature requiring the registration of the person making such commitment on behalf of the member.<sup>61</sup>

One commenter requests clarification regarding the statement in the Notice which provides “covered functions generally would not include a person who engages in administrative responsibilities, such as an initial drafter or code developer. A person who supervises or approves such activities, however, generally would be required to register as an Operations Professional.”<sup>62</sup> The commenter believes this statement runs counter to the proposed supplementary material excluding ancillary functions to a covered function since such supervisor or approver may not have primary responsibility for a covered function.<sup>63</sup> FINRA notes that the proposed rule change does not require primary responsibility for a covered function to trigger registration.<sup>64</sup> FINRA stated that a person who signs off on and/or supervises the activities or personnel involved in writing code to implement firm systems and business requirements is not performing a function that is ancillary to a covered function because their responsibility has a direct nexus to the execution of an activity covered by the proposed rule at a supervisory level.<sup>65</sup>

One commenter requests FINRA acknowledge that firms tailor their supervisory and supervisory control procedures to reflect their business size

and organizational structure, and that as a result, the hierarchy of supervisors registered as Operations Professionals will vary depending on a particular firm’s system of supervision and the particular covered function.<sup>66</sup> Additionally, the commenter requests FINRA acknowledge it is not a presumption that all “managers” with direct reports engaged in covered functions be registered if the responsibility for supervision of the activity, as contemplated by NASD Rule 3010, resides at a higher level of the organization.<sup>67</sup>

FINRA stated that it believes the comment regarding firm supervisory and supervisory control procedures is outside the scope of the proposed rule change.<sup>68</sup> FINRA noted that the proposed rule does not include a requirement regarding a firm’s supervisory and supervisory control procedures.<sup>69</sup> FINRA stated that members are responsible for ensuring that any person who meets the requirements to register as an Operations Professional is appropriately registered, regardless of the firm’s particular supervisory and supervisory control procedures.<sup>70</sup> Additionally, FINRA stated that the proposed rule change creates a function-based registration requirement, so members must examine the activities of their operations personnel to determine who would be required to register.<sup>71</sup> FINRA said it will not make categorical exclusions based on a person’s title or department.<sup>72</sup>

#### B. Covered Functions

FINRA’s proposed rule would require a person to register as an Operations Professional if the person is a “covered person” (discussed in Part A above) with responsibility for one or more of 16 “covered functions.” Proposed Rule 1230(b)(6)(B) defines covered functions as: (i) Client on-boarding (customer account data and document maintenance); (ii) collection, maintenance, re-investment (*i.e.*, sweeps) and disbursement of funds; (iii) receipt and delivery of securities and funds, account transfers; (iv) bank, custody, depository and firm account management and reconciliation; (v) settlement, fail control, buy ins, segregation, possession and control; (vi) trade confirmation and account

statements; (vii) margin; (viii) stock loan/securities lending; (ix) prime brokerage (services to other broker-dealers and financial institutions); (x) approval of pricing models used for valuations; (xi) financial control, including general ledger and treasury; (xii) contributing to the process of preparing and filing financial regulatory reports; (xiii) defining and approving business requirements for sales and trading systems and any other systems related to the covered functions, and validation that these systems meet such business requirements; (xiv) defining and approving business security requirements and policies for information technology, including, but not limited to, systems and data, in connection with the covered functions; (xv) defining and approving information entitlement policies in connection with the covered functions; and (xvi) posting entries to a member’s books and records in connection with the covered functions to ensure integrity and compliance with the Federal securities laws and regulations and FINRA rules.

One commenter urges the SEC to direct FINRA to revise the proposed rule to remove and/or clarify certain covered functions not necessary to achieve the stated objectives of the rule.<sup>73</sup> Another commenter finds certain covered functions unclear and notes firms will incur unnecessary costs by broadly interpreting the covered functions to include activities not intended to be covered by the proposed rule.<sup>74</sup> Another commenter believes the proposed rule change may cause confusion with the use of the term “operations” since the proposed rule spans many different areas of a firm’s business and is not limited to “trading and operations,” which is a distinct area of a firm handling clearing, daily disbursements and account activity.<sup>75</sup> One commenter requests clarification that the covered functions do not cover “client-facing” or “front-office” personnel who may have some involvement in a covered function (*e.g.*, with respect to “client on-boarding” in proposed Rule 1230(b)(6)(B)(i), the activities of unregistered employees who assist in gathering new account forms/documentation and information from customers as part of clerical or administrative duties).<sup>76</sup> The commenter requests this clarification

<sup>58</sup> SIFMA.

<sup>59</sup> Response Letter.

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> T-C Services—1.

<sup>63</sup> T-C Services—1.

<sup>64</sup> Response Letter.

<sup>65</sup> *Id.*

<sup>66</sup> SIFMA.

<sup>67</sup> SIFMA.

<sup>68</sup> Response Letter.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> NSCP.

<sup>74</sup> TLG.

<sup>75</sup> NPH.

<sup>76</sup> SIFMA.

with respect to the other covered functions as well.<sup>77</sup>

FINRA notes that the proposed rule change would affect personnel who meet the depth of personnel in proposed Rule 1230(b)(6)(A) and are engaged in one or more covered functions in proposed Rule 1230(b)(6)(B), and does not distinguish on the basis of whether such persons are “client-facing” or “front-office” personnel.<sup>78</sup> FINRA notes, however, that an unregistered employee who gathers documentation and information in a purely clerical or ministerial capacity likely would not be required to register as an Operations Professional based on the supplementary material in proposed Rule 1230.06.<sup>79</sup>

One commenter requests guidance regarding the term “client on-boarding” in proposed Rule 1230(b)(6)(B)(i) because certain terms commonplace in a general securities business broker-dealer practice are not readily transferable to variable annuity sales, and firms should not be faced with the risk of non-compliance due to unclear rule text.<sup>80</sup> The commenter suggests it may be helpful to link each covered function to FINRA or SEC customer account and recordkeeping rules, similar to the text in proposed Rule 1230(b)(6)(B)(xvi).<sup>81</sup> FINRA declines to amend the proposed rule change to link each of the covered functions to relevant FINRA or SEC rules as it is the responsibility of members to determine the regulatory requirements applicable to the firms’ operations based on their activities.<sup>82</sup> FINRA notes that client on-boarding would include, but is not limited to, account management activities such as customer account initiation and maintenance, related party account information and maintenance, maintaining client terms and conditions and maintaining contact information.<sup>83</sup> FINRA reminded members to view the covered functions in the context of the depth of personnel in proposed Rule 1230(b)(6)(A).<sup>84</sup>

One commenter suggests the covered functions be revised to identify specific functions, responsibilities or activities related to the covered functions (e.g., the covered function “[t]rade confirmation and account statements” (proposed Rule 1230(b)(6)(B)(vi)) fails to provide guidance on what functions,

responsibilities or activities related to the compilation and/or production of account statements would require registration).<sup>85</sup> The commenter notes that many brokerage accounts include cash management features (e.g., linked accounts, online bill pay and payroll check deposit), which are provided via agreements with other financial institutions, and transactional information related to these cash management services is included in the brokerage account statements. The commenter notes that the proposed rule would appear to require the member to register not only the associated persons of the member firm but also the supervisors, managers and others employed by non-member financial institutions.<sup>86</sup> Additionally, the commenter points out that broker-dealers use exchanges and third-party service providers for pricing and valuations under proposed Rule 1230(b)(6)(B)(x) (“[a]pproval of pricing models used for valuations”) and believes that the entire management chain of command at the exchanges or third-party service providers may be required to register as an Operations Professional with the member.<sup>87</sup>

FINRA stated that it views covered persons engaging in one or more of the covered functions on behalf of the member to be associated persons of the member, irrespective of their employing entity, and the proposed rule would require such persons to be registered with FINRA as an Operations Professional.<sup>88</sup> However, FINRA recognizes the distinction between shared services models and arrangements in which another financial institution provides distinct cash management services in connection with a brokerage account.<sup>89</sup> In the latter situation, FINRA states that it would not view the financial institution’s employees to be associated persons of the member.<sup>90</sup> Moreover, with respect to proposed Rule 1230(b)(6)(B)(x), FINRA recognizes that certain data elements may be purchased by a member as part of its execution of certain covered functions, and would not view employees of such providers of data elements to be associated persons of the member based solely on these activities; however, FINRA notes that the proposed rule does not speak to the

propriety of relying on one or more data elements provided by third parties.<sup>91</sup>

One commenter requests that FINRA delete the parenthetical language in FINRA Rule 1230(b)(6)(B)(ix) (“[p]rime brokerage (services to other broker-dealers and financial institutions)”) because the term “prime brokerage” is well understood in the industry and the term “financial institutions” creates ambiguity since it is not defined in the proposed rule.<sup>92</sup> The commenter also recommends modifying proposed Rule 1230(b)(6)(B)(x) (“[a]pproval of pricing models used for valuations”) to “approval of pricing models used for the valuation of customer holdings” since, as proposed, it may sweep in firm risk management or credit functions, which the commenter believes are outside the intent of the proposed rule change.<sup>93</sup> FINRA stated that it does not intend to amend these provisions and notes that the commenter did not provide details regarding the perceived ambiguity in proposed Rule 1230(b)(6)(B)(ix).<sup>94</sup> With respect to the commenter’s concerns with proposed Rule 1230(b)(6)(B)(x), FINRA does not intend to regulate risk management practices of firms through the proposed rule.<sup>95</sup> FINRA stated that nothing in the proposed rule is meant to reach the risk management function of modeling used by firms to calculate capital, margin or liquidity requirements.<sup>96</sup> However, FINRA notes that this provision is not limited to valuations of customer holdings and would include firm holdings of inventory positions.<sup>97</sup>

Three commenters suggest FINRA refine proposed Rule 1230(b)(6)(B)(xii) (“[c]ontributing to the process of preparing and filing financial regulatory reports”) because the phrase “contributing to the process of” is overly broad, interjects unnecessary uncertainty as to who qualifies as a covered person and is inconsistent with the depth of staff concept in subparagraph (A) of the proposed rule.<sup>98</sup> One commenter recommends refining this provision to focus more on the development, creation and maintenance of financial regulatory reports.<sup>99</sup> Another commenter notes that as proposed the function may capture numerous areas that merely provide a support function, including IT, legal and compliance and any area of a

<sup>77</sup> SIFMA.

<sup>78</sup> Response Letter.

<sup>79</sup> *Id.*

<sup>80</sup> Sutherland.

<sup>81</sup> Sutherland.

<sup>82</sup> Response Letter.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> Schwab.

<sup>86</sup> Schwab.

<sup>87</sup> Schwab.

<sup>88</sup> Response Letter.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> Response Letter.

<sup>92</sup> SIFMA.

<sup>93</sup> SIFMA.

<sup>94</sup> Response Letter.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> Response Letter.

<sup>98</sup> SIFMA, T-C Services—1 and WFA.

<sup>99</sup> WFA.

member firm that provides information included in the report.<sup>100</sup>

FINRA stated that it does not intend to amend proposed Rule 1230(b)(6)(B)(xii) because it believes this provision captures the appropriate spectrum of personnel as proposed.<sup>101</sup> FINRA also reiterates that only persons who are both covered persons and conduct activities or functions in one or more of the covered functions would be subject to the new Operations Professional registration category, and that proposed FINRA Rule 1230.06 specifically excludes persons whose activities are limited to performing a function ancillary to a covered function, or whose function is to serve a role that can be viewed as supportive of or advisory to the performance of a covered function (e.g., internal audit, legal or compliance personnel who review but do not have primary responsibility for any covered function), or who engages solely in clerical or ministerial activities in a covered function.<sup>102</sup>

One commenter urges FINRA to refine the scope and application of proposed FINRA Rule 1230(b)(6)(B)(xiv) (“[d]efining and approving business security requirements and policies for information technology, including, but not limited to, systems and data, in connection with the covered functions”) because it could sweep in virtually all individuals who work in a firm’s IT department.<sup>103</sup> Another commenter suggests the covered functions in proposed FINRA Rule 1230(b)(6)(B)(xiii), (xiv), and (xv) should specifically exclude persons executing technical requirements defined and approved by individuals who are supervised by one or more Operations Professionals since, as currently drafted, the proposed rule could sweep in senior management and other supervisors and managers in the IT and IS departments that merely execute the instructions of an area appropriately staffed by an Operations Professional chain of command.<sup>104</sup> One commenter notes that the covered functions in proposed FINRA Rule 1230(b)(6)(B)(xiii) through (xv) are extraneous because personnel in technology do not define and approve business requirements or define and approve business security requirements autonomously without oversight and approval from personnel in the covered functions for which the systems are being designed, and any technology

personnel working directly in a covered function would be subsumed by such covered function and do not require a separate provision.<sup>105</sup> The commenter believes that subparagraphs (xiii) through (xv) are ambiguously worded and confusing, and suggests consolidating the technology covered functions into one function as follows: “information technology (including information security) supporting the other covered functions in paragraph (b)(6)(B) of this Rule.”<sup>106</sup> The commenter suggests supplementary material to the proposed rule to exclude junior technical experts leading a project team from registration as an Operations Professional.<sup>107</sup> The commenter also requests a grace period for passing the examination for technology managers who move into a position requiring registration given that they move from area to area in a large firm and it may be disruptive to firms.<sup>108</sup>

Two commenters request clarification that the proposed rule applies only to those who sign off on requirements and perform testing to validate systems rather than those who build and implement the systems because a broader application of the rule would create significant challenges to the reallocation of technology resources as projects emerge across firms and could lead to challenges in recruiting technology professionals to work in the securities industry.<sup>109</sup> One commenter requests that FINRA clarify language in the rule filing that may conflict with the proposed rule text in proposed Rule 1230(b)(6)(B)(xiii) because it creates ambiguity by suggesting that supervisors of IT development teams that do not define, approve or validate systems may have to register as an Operations Professional, while the proposed rule does not require it.<sup>110</sup>

FINRA stated that it does not intend to make the suggested changes to proposed Rule 1230(b)(6)(B)(xiii) through (xv) as suggested by the commenters because it believes these provisions are clear as proposed.<sup>111</sup> FINRA notes that comments asserting that a covered function could sweep an entire IT department into the proposed

registration category for Operations Professionals fail to consider the covered functions in the context of the depth of personnel set forth in proposed Rule 1230(b)(6)(A).<sup>112</sup> FINRA stated that it does not agree that an entire IT or IS department is likely to meet such a threshold. Member firms are responsible for determining the personnel in IT and IS departments that are engaged in the covered functions at the depth of personnel set forth in proposed Rule 1230(b)(6)(A).

One commenter requests that FINRA revise the language in proposed Rule 1230(b)(6)(B)(xvi) (“[p]osting entries to a member’s books and records in connection with the covered functions to ensure integrity and compliance with the Federal securities laws and regulations and FINRA rules”) to distinguish that only those who define that process, determine how the work is performed and approve the entries be required to register under this provision, akin to the covered functions in proposed Rule 1230(b)(6)(B)(xiii) and (xiv).<sup>113</sup> One commenter recommends deleting proposed Rule 1230(b)(6)(B)(xvi) as redundant because part of the obligation of those performing the covered functions in subparagraphs (i) through (xv) is to comply with the regulatory requirements regarding books and records related to such covered functions.<sup>114</sup>

FINRA stated that it views the covered function relating to a member’s books and records in proposed Rule 1230(b)(6)(B)(xvi) as clearly distinguishable from the IT functions in proposed Rule 1230(b)(6)(B)(xiii) and (xiv), so does not intend to amend the proposed rule as recommended by the commenter.<sup>115</sup> FINRA explains that it is addressing covered persons who define and approve IT systems in one context and covered persons responsible for the function of posting entries to the member’s books and records in the other.<sup>116</sup> Additionally, FINRA states that it believes that the covered function in proposed Rule 1230(b)(6)(B)(xvi) is necessary to make clear that covered persons responsible for books and records posting activities in connection with the covered functions are subject to the proposed requirements.<sup>117</sup>

<sup>105</sup> Goldman.

<sup>106</sup> Goldman.

<sup>107</sup> Goldman.

<sup>108</sup> Goldman.

<sup>109</sup> Edward Jones and SIFMA.

<sup>110</sup> SIFMA. The Proposing Release noted that “the covered functions generally would not include a person who engages in administrative responsibilities, such as an initial drafter or a code developer” but “a person who supervises or approves such activities generally would be required to register as an Operations Professional.”

<sup>111</sup> Response Letter.

<sup>112</sup> *Id.*

<sup>113</sup> WFA.

<sup>114</sup> SIFMA.

<sup>115</sup> Response Letter.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>100</sup> T-C Services—1.

<sup>101</sup> Response Letter.

<sup>102</sup> Response Letter.

<sup>103</sup> FSI.

<sup>104</sup> T-C Services—1.

### *C. Extraterritorial Application of the Proposed Rule*

One commenter believes the proposed rule change imposes an extraterritorial application of U.S. laws.<sup>118</sup> The commenter suggests that the proposed rule raises serious issues under the U.S. Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010) and its holding, according to the commenter, that the Exchange Act should be applied extraterritorially only when explicitly authorized by statute. The commenter posits that there is no plain wording in Exchange Act Section 15A(b)(6) allowing extraterritorial application of the proposed rule change to Canada or elsewhere. The commenter notes that Section 30(b) of the Exchange Act provides that the Exchange Act does not apply "to any person insofar as he transacts a business in securities without the jurisdiction of the United States," unless he does so in violation of regulations promulgated by the SEC "to prevent the evasion of [the Act]."

In addition, the commenter believes the proposed rule conflicts with Exchange Act Rule 15a-6, which, according to the commenter, specifically declines to authorize extraterritorial reach by providing exemptions to certain foreign broker-dealers. The commenter believes the proposed rule change would effectively undermine key exemptions provided by Rule 15a-6 that are extensively relied upon by the international financial services community and could have implications with respect to whether foreign locations are deemed branch offices of a member. The commenter states that the proposed rule would require registration of employees of foreign broker-dealers that are exempt from registration as a U.S. broker-dealer under Rule 15a-6.<sup>119</sup> The commenter states "Canadian employees performing covered functions involving transactions in securities on a Canadian exchange for registered U.S. broker-dealer affiliates would therefore be subject to all FINRA rules, even though their own Canadian employers are exempt from registration as broker-dealers in the U.S., in accordance with SEC Rule 15a-6." The commenter notes that implicit in the Rule 15a-6 broker-to-broker exemption<sup>120</sup> is the

determination that the U.S. broker-dealer will carefully select its foreign counterparts and supervise their performance as it is the U.S. broker-dealer's responsibility for execution, clearance and settlement to its U.S. customers, even when transactions are executed abroad.

The commenter also declares that the proposed rule change would violate the obligations of the U.S. under the North American Free Trade Agreement ("NAFTA") because it would assert extraterritorial reach over cross-border financial activities that were allowed by the SEC at the time the U.S. became a party to NAFTA, and which have since been permitted by the SEC without registration of foreign personnel.<sup>121</sup> The commenter notes that because FINRA's rulemaking power derives from the SEC, its authority can extend no further than that of the SEC. Additionally, the commenter states that FINRA has issued examination deficiencies as if the proposed rule has already been approved and urges the SEC to disapprove the proposed rule change and to take immediate action to cease what it believes is FINRA's de facto enforcement of the proposed requirements. Lastly, the commenter notes that FINRA has failed to consider reasonable alternatives such as evaluating the adequacy of the Canadian regulatory scheme to achieve the regulatory objectives of the proposal and encourages regulatory cooperation in lieu of imposing potentially duplicative requirements.<sup>122</sup>

The commenter's concerns stem from clearing arrangements between a U.S. registered broker-dealer and Canadian firms operating under an exemption from broker-dealer registration in Exchange Act Rule 15a-6(a)(4)(i), in which the Canadian firms clear securities transactions in foreign securities for U.S. institutional investors. FINRA stated that it believes that the commenter's statements with

with or for, or induces or attempts to induce the purchase or sale of any security by a registered broker or dealer, whether the registered broker or dealer is acting as principal for its own account or as agent for others, or a bank acting pursuant to an exception or exemption from the definition of broker or dealer in sections 3(a)(4)(B), 3(a)(4)(E) or 3(a)(5)(C) of the Act."

<sup>121</sup> The commenter asserts that Article 1404(1) of NAFTA prohibits the U.S. from adopting any measure restricting any type of cross-border trade in financial services by cross-border financial services providers of another Party that the Party permits on the date of entry into force of NAFTA, except as provided in Section B of the Party's Schedule to Annex VII. Under Section B, the U.S. reserves the right to adopt any measure relating to cross-border trade in securities services that derogates from Article 1404(1).

<sup>122</sup> A&P.

respect to the proposed rule change make certain assumptions that are not requirements imposed by the proposal.<sup>123</sup> FINRA stated that the proposed rule change does not aim to expand the jurisdiction of FINRA, diverge from Federal law, rules or regulations, U.S. Supreme Court precedent or violate the obligations of the U.S. under NAFTA.<sup>124</sup> FINRA notes that it is a membership organization with jurisdiction over FINRA members and their associated persons by virtue of its By-Laws and membership agreements.<sup>125</sup> FINRA stated that, without opining on the extraterritorial application of U.S. securities laws, it questions the relevance of the *Morrison* decision, which addressed the extraterritorial application of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, and the obligations of the U.S. under NAFTA, to the proposed rule change.<sup>126</sup> FINRA stated that the proposed rule change addresses the obligations of members under FINRA rules with respect to the registration and qualification of certain associated persons who are engaged in, responsible for or supervising certain member operations functions.<sup>127</sup> As noted above, FINRA stated that its jurisdiction reaches associated persons of members and their activities, regardless of their employing entity.<sup>128</sup> The Commission agrees with FINRA that the proposed rule does not expand FINRA's jurisdiction. Furthermore, FINRA stated that it is not within its purview to interpret the Federal securities laws or SEC rules.<sup>129</sup>

Additionally, FINRA disagrees with the commenter's assessment of an implied application of a proposed FINRA rule.<sup>130</sup> As stated by the commenter,<sup>131</sup> and without independent verification or comment, FINRA noted that the examination findings cited by the commenter relate to the firm's outsourcing arrangements and compliance with Exchange Act Rule 15c3-3(k)(2)(i), and the comment is outside the scope of the proposed rule change.<sup>132</sup>

### *D. Examination Requirement*

One commenter states that an examination requirement provides no benefit to investors and FINRA is the

<sup>118</sup> A&P.

<sup>119</sup> A&P.

<sup>120</sup> The commenter represents firms operating under an exemption in Exchange Act Rule 15a-6(a)(4)(i), 17 CFR 240.15a-6(a)(4)(i), known as the broker-to-broker exemption, which provides "[a] foreign broker or dealer shall be exempt from the registration requirements of sections 15(a)(1) or 15B(a)(1) of the Act to the extent that the foreign broker or dealer effects transactions in securities

<sup>123</sup> Response Letter.

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> A&P, at note 1.

<sup>132</sup> Response Letter.



true winner as it collects fees for testing, continuing education and other potential items it will generate.<sup>133</sup> Another commenter asserts that a qualification examination is unnecessary to meet the objectives of the proposal and recommends using firm written supervisory procedures and Firm Element training.<sup>134</sup> Two commenters state FINRA should carefully evaluate the objectives and consequences of a one-size-fits-all examination requirement on potential test takers and recommend internal firm element training to deliver the proposed product, market and operations knowledge portion of the required examination content.<sup>135</sup> One commenter supports the original intent of the examination requirement, which was to establish a “spot-the-red-flags” examination that would train test takers to identify and escalate potential control problems, and believes that the scope should not be expanded to cover the details of different products, operations processes and rules and regulations given the breadth of the covered functions.<sup>136</sup> Further, the commenter notes that a high failure rate will cause operational disruption at firms.<sup>137</sup> One commenter notes that the examination will be overbroad and extremely challenging for many test takers, especially IT personnel who serve across the covered functions who may have particular difficulty given their minimal background or experience in industry issues.<sup>138</sup>

FINRA stated that it believes that the proposed qualification examination requirement for Operations Professionals is appropriate as proposed and does not agree that the objectives of the proposal can be attained without a testing requirement for unregistered personnel.<sup>139</sup> As FINRA noted in the Notice, it believes there is value in an examination that tests for general securities knowledge about the securities industry and that ongoing continuing education will supplement this knowledge for Operations Professionals.<sup>140</sup> FINRA stated that the

draft content outline for the proposed Operations Professional examination was developed by FINRA staff in conjunction with industry subject matter expert volunteers.<sup>141</sup> FINRA stated that its staff conducted several focus panels in mid-2010 with operations professionals working in one or more of the covered functions and from a wide range of FINRA member firms.<sup>142</sup> FINRA said that it then convened an Operations Professional exam committee consisting of more than 40 operations professionals; such persons represent a broad range of FINRA members, including size, geographical location and business model.<sup>143</sup> FINRA stated that both FINRA staff and committee members placed an emphasis on creating a content outline and questions that are appropriate across all the covered functions and test the appropriate level of knowledge for a person who meets the depth of personnel as an Operations Professional.<sup>144</sup>

#### *E. Exception to Qualification Examination Requirement*

FINRA noted that the proposed rule change would include an exception to the Operations Professional qualification examination requirement for persons who currently hold certain registrations (each an “eligible registration”) or have held one during the two years immediately prior to registering as an Operations Professional.<sup>145</sup> FINRA stated that the proposed exception also would apply to persons who do not hold an eligible registration, but prefer an alternative to taking the Operations Professional examination.<sup>146</sup> FINRA said such persons would be permitted to register in an eligible registration category (subject to passing the corresponding qualification examination or obtaining a waiver) and use such registration to qualify for Operations Professional registration.<sup>147</sup>

One commenter questions the value of an additional registration category with such a broad exception since the majority of individuals that would be subject to the proposed rule change would be eligible for the proposed exception.<sup>148</sup> To provide a clearer indication that the proposed rule change is necessary, the commenter recommends FINRA engage in an

industry-wide survey to determine how many individuals would not qualify for the exception.<sup>149</sup> Two commenters assert that the proposed exception is overly broad and will undermine the regulatory purpose of the proposal.<sup>150</sup> One such commenter believes content overlap of the eligible registration qualification examinations with the proposed Operations Professional examination is not sufficient justification to accept one examination in lieu of another and finds it inappropriate to grant a waiver to an individual who has passed certain examinations that are limited in nature (e.g., Series 6).<sup>151</sup>

One commenter recommends exempting persons who qualify for the proposed exception from the requirement to separately register as an Operations Professional (noting that costs to make internal system changes to track and monitor dual registrations may be significant), since FINRA’s stated goal is to ensure that covered persons are registered with FINRA and trained on industry practices.<sup>152</sup> Another commenter suggests FINRA specifically exempt supervisory personnel who hold the most senior supervisory qualifications (i.e., Series 24 and Series 27) from the requirement to register as an Operations Professional based on the same policy reasoning for exempting certain licensed individuals from the examination requirement.<sup>153</sup> Another commenter recommends FINRA include as an eligible registration the UK FSA-approved Securities & Investment Level 3 Investment Operations Certificate (IOC) and the Investment Administration Qualification (IAQ), both widely recognized within the financial services industry in the UK.<sup>154</sup>

Given the significant functions performed by Operations Professionals, FINRA stated that it believes a separate registration category for such personnel is an appropriate measure to enhance the operational integrity of members.<sup>155</sup> FINRA stated that, as noted in the Notice, a primary purpose of the proposed qualification examination is to assess a covered person’s basic understanding of the securities industry and the requirement to take a registration examination serves to alert such person of the role he or she plays

<sup>133</sup> Callaway.

<sup>134</sup> FSI.

<sup>135</sup> NSCP and TLG.

<sup>136</sup> SIFMA.

<sup>137</sup> SIFMA.

<sup>138</sup> NSCP.

<sup>139</sup> Response Letter.

<sup>140</sup> FINRA notes that NASD Rule 1070 (Qualification Examinations and Waiver of Requirements), as well as other applicable provisions regarding registration and qualification set forth in FINRA’s rulebook, such as NASD Rule 1031(c) regarding requirements for examination on lapse of registration, would apply to the Operations Professional qualification examination and registration category.

<sup>141</sup> Response Letter.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> Response Letter.

<sup>148</sup> NPH.

<sup>149</sup> NPH.

<sup>150</sup> NASAA and NPH.

<sup>151</sup> NASAA.

<sup>152</sup> NMIS.

<sup>153</sup> Goldman.

<sup>154</sup> SIFMA.

<sup>155</sup> Response Letter.



in this highly regulated environment.<sup>156</sup> Thus, FINRA believes the eligible registrations (and corresponding examinations) serve as a valid proxy for the Operations Professional examination requirement.<sup>157</sup> In addition, FINRA is proposing to add language to proposed Rule 1230(b)(6)(D) to provide that FINRA staff may accept as an alternative to the Operations Professional qualification examination requirement any domestic or foreign qualification if it determines that acceptance of such alternative qualification is consistent with the purposes of the rule, the protection of investors, and the public interest.<sup>158</sup>

FINRA stated that the proposed exception applies to the Operations Professional examination requirement only and not Firm Element training.<sup>159</sup> FINRA noted that individuals who avail themselves of the proposed exception to the Operations Professional examination requirement with an eligible registration would be subject to the Regulatory Element program appropriate for such other registration category; however, Operations Professionals would be subject to Firm Element training based on their activities at the firm, which would include the activities in the covered functions that mandate their registration as an Operations Professional.<sup>160</sup>

#### *F. Implementation Period and Grace Period for Non-Clearing Firms*

FINRA stated that in *Regulatory Notice* 10–25, it proposed a six- to nine-month transition period for the proposed rule change.<sup>161</sup> In the Notice, FINRA proposed to a 60-day identification period beginning on the effective date of the proposed rule change during which persons required to register as an Operations Professional as of the effective date of the proposed rule change (“Day-One Professionals”) must request registration as an Operations Professional via Form U4 in CRD. Day-One Professionals who are identified during the 60-day period and must pass the Operations Professional examination (or an eligible qualification examination) to qualify would be granted 12 months beginning on the effective date of the proposed rule change to pass such qualifying examination, during which time such persons may function as an Operations Professional. The 12-month transition

period to pass a qualification examination would only apply to Day-One Professionals so any person who is not subject to the registration requirements for Operations Professionals as of the effective date of the proposed rule change (“non-Day-One Professionals”) would be required to register as an Operations Professional and, if applicable, pass the Operations Professional qualification examination (or an eligible qualification examination), prior to engaging in any activities that would require such registration. However, any non-Day-One Professional associated with a non-clearing member who must pass the Operations Professional qualification examination (or an eligible qualification examination) to obtain registration would be granted a grace period of 120 days beginning on the date such person requests Operations Professional registration to pass such qualifying examination, during which time such person may function as an Operations Professional.

One commenter believes the proposed implementation period would place an undue burden on the industry and may cause serious disruptions as firms reallocate employee time and resources away from other critical areas.<sup>162</sup> The commenter suggests a three-month identification period followed by a 12-month period for such employees to pass a qualification examination, since the potential burdens and risks of the proposed timeframe far outweigh the minor benefit of the rule being fully effective a few months earlier.<sup>163</sup> Another commenter recommends non-Day-One Professionals, regardless of when they become subject to the proposed registration requirements, be eligible for the 12-month transition period to pass a qualifying examination.<sup>164</sup>

FINRA stated that it does not intend to further extend the proposed implementation period as it believes that the proposed implementation period provides adequate time for members to comply with the proposed rule change.<sup>165</sup> FINRA noted that *Regulatory Notice* 10–25 was published for comment in May 2010, and that the proposed rule change was filed in March 2011.<sup>166</sup> FINRA stated that members have been aware of the proposed rule change for over a year.<sup>167</sup> FINRA stated that it will announce an

effective date for the proposed rule change in a *Regulatory Notice* following Commission approval and firms will have 60 days following the effective date of the rule change to identify Day-One Professionals, in addition to the 12-month transition period for those Day-One Professionals who must pass a qualification examination.<sup>168</sup>

One commenter suggests FINRA provide firms with the ability to upload a “batch” file of Form U4 registration requests to the CRD system at the conclusion of the initial identification period for Day-One Professionals, since the requirement to maintain dual registrations for such individuals will be administratively complex.<sup>169</sup> FINRA believes that the current Web-based Electronic File Transfer functionality (Web EFT) will enable subscribers to efficiently batch file uploads to Web CRD following approval of the proposed rule change by the Commission.<sup>170</sup>

Numerous commenters suggest extending the 120-day grace period for non-Day-One Professionals associated with a non-clearing member to persons associated with a clearing member firm because similar disruptions to firm operations and client services also may occur at clearing members.<sup>171</sup> Certain commenters believe that if an extension is granted, such individuals should report to a registered Operations Professional or another registered person during the 120-day grace period.<sup>172</sup> One commenter maintains that limiting the 120-day grace period to non-clearing members will force clearing firms to place potentially inexperienced or unqualified employees in a supervisory role simply because they are Operations Professionals, and notes that FINRA should not expect that clearing firms have additional supervisory staff on standby for each department responsible for a covered function.<sup>173</sup> Another commenter notes that without the grace period, a clearing firm may not be able to hire and train new staff on a timely basis or quickly replace staff in the event of a sudden departure, which may disrupt the member’s operations and present a significant business continuity risk.<sup>174</sup> The commenter further asserts that the risk involved in extending the grace period to clearing firms is low given that there will be multiple registered persons in the covered areas, members have

<sup>168</sup> *Id.*

<sup>169</sup> SIFMA.

<sup>170</sup> Response Letter.

<sup>171</sup> Edward Jones, JMS, NSCP, Schwab, SIFMA and WFA.

<sup>172</sup> Edward Jones, SIFMA and WFA.

<sup>173</sup> JMS.

<sup>174</sup> SIFMA.

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> SIFMA.

<sup>163</sup> SIFMA.

<sup>164</sup> NSCP.

<sup>165</sup> Response Letter.

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

incentive to hire or promote persons qualified to fill vacancies that would require registration, newly hired or promoted persons will be supervised by a registered person and such persons will not be directly interacting with clients.<sup>175</sup>

Based on the comments, FINRA is proposing to extend the 120-day grace period to pass a qualification examination to non-Day-One Professionals associated with a clearing member firm, since clearing firms may experience similar resource challenges in finding qualified new hires and transitioning staff into roles in the covered functions that would require Operations Professional registration.<sup>176</sup>

### *G. Coordinate Proposed Rule Change With Other FINRA Rule Proposals*

Two commenters recommend FINRA coordinate the proposed rule change with other FINRA rule proposals. One commenter requests parallel implementation of the proposed rule change and the proposed registration rules for a coherent, non-duplicative, understandable framework for registration (including the issuance by FINRA of an integrated, comprehensive Notice addressing the comments received on both proposals) since ad hoc implementation of the new registration categories would cause significant burdens to members.<sup>177</sup> Another commenter requests FINRA extend the action date for the proposed rule change so it coincides with the expiration of the comment period for *Regulatory Notice* 11–14 (Third-Party Service Providers) to allow members to consider these closely related proposals concurrently.<sup>178</sup>

FINRA stated that, while it appreciates the commenters' concerns regarding coordination of related rule changes, it believes that the proposed rule change requiring registration of Operations Professionals can proceed now without overly burdening or confusing members.<sup>179</sup> FINRA believes registration and education requirements for the specified operations personnel are needed to help ensure that investor protection mechanisms are in place for all areas of a member's business that could harm the member, a customer, the integrity of the marketplace or the public.<sup>180</sup> FINRA believes that such enhancements should not be unnecessarily postponed, and that it can

work with members in implementing future proposed registration rules and requirements relating to third-party service providers separate and apart from the proposed rule change addressing Operations Professional registration.<sup>181</sup>

### *H. Rulemaking Process*

In the Notice, FINRA stated that additional guidance may be needed following the adoption of the proposed rule change and that it would address interpretive questions as needed, similar to its approach to other regulatory initiatives with wide-ranging and novel impacts.<sup>182</sup> One commenter believes that a delay in providing guidance will create confusion and inconsistencies in compliance with the proposed rule, an increased burden on firms in their efforts to comply and hinder FINRA in meeting the objectives of the proposal by failing to provide a clear framework for the proposed requirements.<sup>183</sup> The commenter requests FINRA provide more information regarding industry consultations that took place during the rulemaking process, as the commenter is concerned that a lack of transparency in the rulemaking process will lead to the disenfranchisement of certain segments of the industry.<sup>184</sup>

FINRA believes that it has provided ongoing guidance with respect to the proposed rule change.<sup>185</sup> FINRA stated that it cannot address every specific interpretive issue that may arise in the rulemaking process but has attempted to provide guidance where necessary to assist members in understanding the proposed rule change.<sup>186</sup> FINRA stated that, as with most significant rule proposals, FINRA engaged the industry in crafting the proposed rule change.<sup>187</sup> FINRA said it consulted with industry groups, its advisory committees and panels with representatives from a cross-section of member firms that provided critical input into the depth of personnel for covered persons, the functions for inclusion in the covered functions in the proposed rule and the content of the proposed Operations Professional qualification examination.<sup>188</sup>

### *I. Costs*

One commenter suggests giving the industry flexible and less burdensome alternatives to a new costly registration

requirement so they do not have to increase the costs of doing business, stating that FINRA does not justify why registration is the sole effective and cost-efficient means of accomplishing the objectives of the proposal.<sup>189</sup> FINRA believes the proposed rule change is necessary to help ensure that investor protection mechanisms of the highest level possible are in place in all areas of a member's business that could harm the member, a customer, the integrity of the marketplace or the public.<sup>190</sup> FINRA believes that the proposed registration, qualification examination and continuing education requirements for Operations Professionals will best achieve this result.<sup>191</sup>

### **III. Commission's Findings**

After careful review of the proposed rule change, the comment letters and the FINRA Response Letter, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.<sup>192</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>193</sup> which requires, among other things, that FINRA rules 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.

Although FINRA's registration regime historically has focused on "front office" personnel who have contact with customers or are otherwise directly involved in effecting securities transactions, persons who perform "back office" functions, such as recordkeeping, trade confirmation, transaction settlement, internal auditing, and securities lending operations<sup>194</sup> are also important to a FINRA member's ability to comply with its responsibilities under the Federal securities laws and regulations, and the rules of FINRA. Given the growing complexity of the industry, and the

<sup>189</sup> WFA.

<sup>190</sup> Response Letter.

<sup>191</sup> *Id.*

<sup>192</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>193</sup> 15 U.S.C. 78o-3(b)(6).

<sup>194</sup> We note that Section 984 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010), addresses securities lending by, among other things, giving the Commission express authority to regulate persons that "effect, accept, or facilitate a transaction involving the loan or borrowing of securities."

<sup>175</sup> SIFMA.

<sup>176</sup> Response Letter.

<sup>177</sup> Sutherland. See *Regulatory Notice* 09–70.

<sup>178</sup> JMS.

<sup>179</sup> Response Letter.

<sup>180</sup> *Id.*

<sup>181</sup> *Id.*

<sup>182</sup> Response Letter.

<sup>183</sup> Sutherland.

<sup>184</sup> Sutherland.

<sup>185</sup> Response Letter.

<sup>186</sup> *Id.*

<sup>187</sup> *Id.*

<sup>188</sup> Response Letter.

importance of the services provided by the back-office personnel, the Commission believes that FINRA's proposal to license and register Operations Professionals and to require members to provide Operations Professionals with continuing education, as amended by Amendment No. 1, will help to address regulatory gaps in this area.

The Commission believes that FINRA carefully considered all the comments on the proposal and has responded appropriately. FINRA's Amendment No. 1 changes the proposed rule change in response to certain requests by commenters to clarify the categories of covered persons, accept certain alternative qualification examinations in lieu of the Operations Professional examination, and to extend the 120-day grace period for registration of non-Day-One Professionals to those who will be associated with a clearing member. FINRA has suitably explained its reasons for declining to amend the proposed rule in response to the remainder of the comments it received.

#### IV. Accelerated Approval

The Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act,<sup>195</sup> for approving the proposed rule change, as modified by Amendment No. 1 thereto, prior to the 30th day after publication of notice of the filing of Amendment No. 1 in the **Federal Register**. The proposed rule change was informed by FINRA's consideration of, and the incorporation of many suggestions made in, extensive comments on FINRA's proposal to require the registration of Operations Professionals, and Amendment No. 1's modifications to the proposed rule change add clarity to the proposed rule and provide additional guidance to members and their associated persons.

Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by Amendment No. 1, on an accelerated basis.

#### V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as modified by Amendment No. 1, 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-2011-013 on the subject line.

##### *Paper Comments*

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

All submissions should refer to File Number SR-FINRA-2011-013. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<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 Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2011-013 and should be submitted on or before July 13, 2011.

#### VI. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>196</sup> that the proposed rule change (SR-FINRA-2011-013), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>197</sup>

**Cathy H. Ahn,**

*Deputy Secretary.*

[FR Doc. 2011-15450 Filed 6-21-11; 8:45 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-64686; File No. SR-CHX-2011-07]

### Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Approving a Proposed Rule Change To Amend Minor Rule Plan

June 16, 2011.

#### I. Introduction

On April 20, 2011, the Chicago Stock Exchange, Inc. ("CHX" or the "Exchange") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change amending CHX Article 12, Rule 8 (Minor Rule Plan) ("MRP") to incorporate additional violations into the MRP, increase the sanctions for certain violations, add censure authority to the MRP, eliminate the Minor Rule Violation Panel, clarify pleading requirements of a Respondent seeking to challenge a sanction by instituting a formal disciplinary proceeding, and make other minor changes. The proposed rule change was published for comment in the **Federal Register** on May 5, 2011.<sup>3</sup> The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

#### II. Description

The Exchange proposed to make additional rules subject to punishment under its MRP. These rules relate to: (1) Failure to notify the Exchange of a request to withdraw capital contribution (Article 3, Rule 6(b)); (2) failure to request Exchange approval of the transfer of equity securities of a participant firm (Article 3, Rule 11); (3) reporting of loans (Article 3, Rule 12); (4) failure to provide the Exchange with information (Article 6, Rule 7); (5) impeding or delaying an Exchange examination, inquiry, or investigation (Article 6, Rule 9); (6) designation of e-mail addresses (Article 3, Rule 13); (7) registration and approval of personnel (Article 6, Rule 2(a)); (8) written supervisory procedures (Article 6, Rule 5(b)); (9) failure to report short positions (Article 7, Rule 9); (10) furnishing of records (Article 11, Rule 1); (11) maintenance of books and records (Article 11, Rule 2); (12) participant

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

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

<sup>3</sup> See Securities Exchange Act Release No. 64370 (April 29, 2011); 76 FR 25727 ("Notice").

<sup>195</sup> 15 U.S.C. 78s(b)(2).

<sup>196</sup> 15 U.S.C. 78s(b)(2).

<sup>197</sup> 17 CFR 200.30-3(a)(12).