

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 47	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - 2014 - * 038 Amendment No. (req. for Amendments *)
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Filing by Financial Industry Regulatory Authority  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	Rule <input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(3) <input type="checkbox"/> 19b-4(f)(6)		

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) * <input type="checkbox"/>	Section 806(e)(2) * <input type="checkbox"/>
	Section 3C(b)(2) * <input type="checkbox"/>

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

Proposed Rule Change to Adopt FINRA Rule 3110(e) (Responsibility of Member to Investigate Applicants for Registration) in the Consolidated FINRA Rulebook

**Contact Information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name \* Afshin    Last Name \* Atabaki  
 Title \* Associate General Counsel  
 E-mail \* afshin.atabaki@finra.org  
 Telephone \* (202) 728-8902    Fax (202) 728-8264

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)  
 Vice President and Associate General Counsel

Date 09/17/2014  
 By James S. Wrona  
 (Name \*)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

jim.wrona@finra.org, jim.wrona@finra.org

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

**1. Text of the Proposed Rule Change**

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “SEA”),<sup>1</sup> Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to adopt NASD Rule 3010(e) (Qualifications Investigated) relating to background investigations as FINRA Rule 3110(e) (Responsibility of Member to Investigate Applicants for Registration) in the consolidated FINRA rulebook. The proposed rule change streamlines and clarifies the rule language and adds a provision to require members to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant’s Form U4 (Uniform Application for Securities Industry Registration or Transfer). In addition, the proposed rule change adds Supplementary Material .15 (Temporary Program to Address Underreported Form U4 Information) to FINRA Rule 3110 (Supervision) to establish a temporary program that will issue a refund to members of Late Disclosure Fees assessed for the late filing of responses to Form U4 Question 14M, subject to specified conditions.

The proposed rule change would delete NASD Rule 3010(f) (Applicant’s Responsibility), Incorporated NYSE Rule 345.11 (Investigation and Records) and Incorporated NYSE Rule Interpretation 345.11/01 (Application – Investigation) and /02 (Application – Records).

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

(b) Upon Commission approval and implementation by FINRA of the proposed rule

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

change, NASD Rule 3010(e), NASD Rule 3010(f), Incorporated NYSE Rule 345.11 and Incorporated NYSE Rule Interpretation 345.11/01 and /02 will be eliminated from the current FINRA rulebook.

(c) Not applicable.

## **2. Procedures of the Self-Regulatory Organization**

At its meeting on April 24, 2014, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA proposes to implement proposed FINRA Rule 3110(e) on December 1, 2014, which coincides with the implementation date for the consolidated FINRA supervision rules. FINRA will announce the effective date of proposed FINRA Rule 3110(e) in a Regulatory Notice to be published no later than 90 days following Commission approval.

Proposed FINRA Rule 3110.15 has a retroactive effective date of April 24, 2014, and it will automatically sunset on March 31, 2015.

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

(a) Purpose

As part of the process of developing a new consolidated rulebook ("Consolidated FINRA Rulebook"),<sup>2</sup> FINRA is proposing to adopt NASD Rule 3010(e) relating to

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<sup>2</sup> The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules") (together, the NASD Rules and Incorporated NYSE Rules are referred to as the "Transitional Rulebook"). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also

background investigations as FINRA Rule 3110(e). The proposed rule change streamlines and clarifies the rule language. In addition, the proposed rule change adds a provision to proposed FINRA Rule 3110(e) to require members to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant's Form U4 as described below. Further, the proposed rule change adds Supplementary Material .15 to FINRA Rule 3110 to establish a temporary program that will issue a refund to members of Late Disclosure Fees assessed for the late filing of responses to Form U4 Question 14M, subject to specified conditions.

The proposed rule change would delete NASD Rule 3010(f) because it has been rendered obsolete. The proposed rule change would also delete Incorporated NYSE Rule 345.11<sup>3</sup> and NYSE Rule Interpretation 345.11/01 and /02 as they are substantially similar to proposed FINRA Rule 3110(e), addressed by other rules or otherwise rendered obsolete by the proposed approach reflected in FINRA Rule 3110(e).

#### I. Existing Requirements

A critical part of the registration process in the securities industry is the background investigation of applicants for registration and the timely and accurate reporting of information to the Central Registration Depository (CRD®) system via the Form U4. For instance, FINRA reviews the information disclosed on the Form U4 to

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members of the NYSE ("Dual Members"). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice March 12, 2008 (Rulebook Consolidation Process).

<sup>3</sup> For convenience, the proposed rule change refers to Incorporated NYSE Rules as NYSE Rules.

determine whether an applicant is subject to a statutory disqualification<sup>4</sup> or whether the applicant may present a regulatory risk for the firm and customers. Further, firms use the information reported to the CRD system to determine whether an applicant is subject to a statutory disqualification and to conduct background checks on applicants when making registration decisions. In addition, the information that FINRA releases to the public through BrokerCheck, which helps investors make informed choices about the individuals and firms with which they conduct business, is derived from the CRD system.

NASD Rule 3010(e) provides that a firm must ascertain by investigation the good character, business reputation, qualifications and experience of an applicant before the firm applies to register that applicant with FINRA.<sup>5</sup> NASD Rule 3010(e) does not place any limits on the scope of such a background investigation – a firm must obtain all the necessary information to make an evaluation.<sup>6</sup> In addition, if the applicant previously has been registered with FINRA, NASD Rule 3010(e) specifically requires that the firm review a copy of the applicant's most recent Form U5 (Uniform Termination Notice for

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<sup>4</sup> See Sections 3(a)(39) and 15(b)(4) of the Act.

<sup>5</sup> Firms must comply with MSRB Rule G-7 (Information Concerning Associated Persons) regarding those applicants engaged solely in municipal securities activities.

<sup>6</sup> FINRA has stated that firms should consider all available information gathered in the pre-registration process for this purpose, including, but not limited to Forms U4 and U5 responses, authorized searches of the CRD system, fingerprint results obtained under SEA Rule 17f-2 and communications with previous employers, and that firms also may wish to consider private background checks, credit reports and reference letters. See Regulatory Notice 07-55 (November 2007). In addition, FINRA has stated that firms must ensure that such background investigations are conducted in accordance with all applicable laws, rules and regulations (including federal and state requirements) and that all necessary approvals, consents and authorizations have been obtained. See Regulatory Notice 07-55.

Securities Industry Registration) within 60 days of the filing date of an application for registration or demonstrate that it has made reasonable efforts to do so.<sup>7</sup>

NYSE Rule 345.11, which is the corresponding NYSE rule, requires firms to investigate thoroughly the previous record of: (1) persons required to be registered with the NYSE; (2) persons who regularly handle or process securities or monies or maintain the books and records relating to securities or monies who are not otherwise required to be registered; and (3) persons having direct supervisory responsibility over persons engaged in the above activities who are not otherwise required to be registered.<sup>8</sup> For persons required to be registered with the NYSE, firms generally fulfill their investigative obligation by verifying the information contained in the Form U4 and by reviewing the applicant's most recent Form U5, if the applicant previously has been registered. For persons subject to NYSE Rule 345.11 who are not required to be registered, firms generally fulfill their investigative obligation by verifying the information contained in the employment questionnaire or application required under SEA Rule 17a-3(a)(12)(i).<sup>9</sup>

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<sup>7</sup> If the applicant has been recently employed by a Futures Commission Merchant or an Introducing Broker that is notice-registered with the SEC pursuant to Section 15(b)(11) of the Act, the registering firm also is required to review a copy of the individual's most recent CFTC Form 8-T.

<sup>8</sup> See also NYSE Rule Interpretation 345.11/01 and /02.

<sup>9</sup> SEA Rule 17a-3(a)(12)(i) requires that a broker-dealer make and keep current a questionnaire or application for employment executed by each associated person, other than persons whose functions are solely clerical or ministerial. The questionnaire or application must be approved in writing by an authorized representative and must, among other information, contain the associated person's employment, disciplinary and criminal history. If an associated person is a registered person of the broker-dealer, then retention of a full, correct and complete copy of the associated person's originally executed Form U4 for registration with FINRA or other regulatory agency is sufficient to satisfy this requirement.

NYSE Rule 345.11 also requires firms to make further inquiry, where appropriate, in light of the background information developed, the position for which the person is being considered or other circumstances.

The Form U4 requires that the person signing the form on behalf of the firm certify that he or she has taken appropriate steps to verify the accuracy and completeness of the information contained in and with that form.<sup>10</sup>

II. Proposed FINRA Rule 3110(e)

FINRA is proposing to amend FINRA Rule 3110 by adding a new paragraph (e) and incorporating the requirements of NASD Rule 3010(e) into that paragraph, subject to the following changes.

FINRA is proposing to streamline and clarify the rule language. For instance, NASD Rule 3010(e) currently provides that “[e]ach member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making such a certification in the application of such person for registration with this Association,” whereas proposed FINRA Rule

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<sup>10</sup> The Form U4 also provides that the person signing the form on behalf of the firm certify that the firm has communicated with the applicant’s previous employers for the past three years and has documentation on file with the names of the persons contacted and the date of contact. In addition, members have an obligation to comply with SEA Rule 17f-2. Pursuant to SEA Rule 17f-2, specific persons employed in the securities industry are required to be fingerprinted for purposes of a criminal background check. Firms are responsible for obtaining a prospective employee’s fingerprints and required identifying information. Firms then submit the prospective employee’s fingerprints together with the required identifying information to FINRA. FINRA, in turn, submits these fingerprints to the FBI. FINRA also makes the fingerprint results available to the employing member and regulators, consistent with applicable federal laws and FBI and FINRA requirements. See Notice to Members 05-39 (May 2005).



3110(e) provides that “[e]ach member shall ascertain by investigation the good character, business reputation, qualifications and experience of an applicant before the member applies to register that applicant with FINRA and before making a representation to that effect on the application for registration.” Further, proposed FINRA Rule 3110(e) clarifies that a firm is required to review a copy of an applicant’s most recent Form U5 if the applicant previously has been registered with FINRA or another self-regulatory organization. With respect to a firm’s obligation to review an applicant’s Form U5, the proposed rule continues to provide that if the firm is unable to review the Form U5, it has to demonstrate that it has made reasonable efforts to do so. FINRA expects firms to use this provision in very limited circumstances, such as where the previous firm fails to file a Form U5 or goes out of business before filing a Form U5. FINRA also is proposing to re-label current FINRA Rule 3110(e) (Definitions) as FINRA Rule 3110(f) (Definitions) and update the cross-references in FINRA Rule 3110 to reflect this change.

In addition, FINRA is proposing to include in proposed FINRA Rule 3110(e) a requirement that firms adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant’s Form U4 no later than 30 calendar days after the form is filed with FINRA. FINRA believes that such a requirement is consistent with the requirements of NYSE Rule 345.11 and the Form U4. The proposed requirement would only apply to an initial or a transfer Form U4 for an applicant for registration, and not to Form U4 amendments. FINRA further believes that imposing such a requirement would not be unduly burdensome for firms; FINRA expects that firms already have a review process in place to verify the information contained in the Form U4 for most applicants for registration.

Proposed FINRA Rule 3110(e) would also require that a firm's written procedures must, at a minimum, provide for a search of reasonably available public records<sup>11</sup> conducted by the member or a third-party service provider to verify the accuracy and completeness of the information contained in an applicant's Form U4.<sup>12</sup> The requirement to conduct a public records search must be satisfied no later than 30 calendar days after the initial or transfer Form U4 is filed with FINRA, with the understanding that if a member becomes aware of any discrepancies as a result of a public records search conducted after the filing of the Form U4, the member would be required to file an amended Form U4 with FINRA. As discussed in more detail below, FINRA does not believe that this requirement would be unduly burdensome for members given the availability of online access to public records databases and the relatively low cost of hiring a third-party service provider to conduct such a search. Therefore, this requirement would provide firms with a relatively low cost method to verify that all disclosure events evidenced in reasonably available public records have been reported on the Form U4. In addition, FINRA is aware that many firms already have a review process in place that entails searching public records, and therefore the proposed requirement will not impose significant burdens on these firms.

A member could comply with the requirement to conduct a public records search in several ways. For example, a member may satisfy the requirement by: (1)(a)

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<sup>11</sup> Public records include, but are not limited to: general information, such as name and address of individuals; criminal records; bankruptcy records; civil litigations and judgments; liens; and business records.

<sup>12</sup> The requirement to conduct a public records search would be limited to a national search; it would not extend to public records searches in foreign jurisdictions.

reviewing a credit report from a major national credit reporting agency that contains public record information (such as bankruptcies, judgments and liens), or (b) searching a reputable national public records database; and (2) reviewing the fingerprint results obtained as part of the registration process. Alternatively, a member could comply with this requirement by using the services of a specialized provider, such as Business Information Group, Inc. (BIG),<sup>13</sup> to provide the firm with a consolidated report of a national public records search, which includes a search of financial and criminal public records. A member may find it necessary to conduct a more in-depth search of an applicant's background depending on the applicant's job function, responsibilities or position at the firm.

FINRA encourages firms to conduct the required public records search prior to filing the initial or transfer Form U4 to avoid the fees associated with filing a Form U4 amendment. In addition, FINRA recognizes that there will on occasion be circumstances beyond a firm's control that prevent completion of the verification process within 30 calendar days after the Form U4 is filed with FINRA. For example, where a firm is relying on fingerprint results for purposes of a criminal public records search, and the FBI determines the fingerprints to be "illegible" and requires resubmission of the fingerprints. In such circumstances, the firm's procedures should provide that the verification should be completed as soon as is practical.

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<sup>13</sup> FINRA has contracted with BIG to provide competitive pricing to members that are conducting background investigations of applicants, currently at a cost of \$10 to \$13 per applicant (depending on volume). In general, FINRA does not endorse any particular third-party service and a firm's use of BIG's services, or the services of any other specific provider, would not be deemed to be a safe harbor by FINRA.

As noted above, FINRA is proposing to implement proposed FINRA Rule 3110(e) on December 1, 2014, which coincides with the implementation date for the consolidated FINRA supervision rules. FINRA will announce the effective date of proposed FINRA Rule 3110(e) in a Regulatory Notice to be published no later than 90 days following Commission approval.

III. Proposed FINRA Rule 3110.15

As announced by FINRA on April 24, 2014, to verify against public records whether material financial information has been timely and accurately reported to the CRD system via the Form U4, FINRA is performing a one-time search of specific financial public records, including bankruptcies, judgments and liens, on all registered persons.<sup>14</sup> In addition, as part of this effort and to verify against public records whether material criminal information has been accurately reported to the CRD system via the Form U4, FINRA is performing an ongoing search of specific criminal public records on a risk-based basis and on any registered person who has not been fingerprinted within the past five years. FINRA is using one or more national information providers in the conduct of these reviews. The reviews are performed against readily available, online public records.

In the course of these reviews, if FINRA identifies instances where required information has not been reported to the CRD system via the Form U4, FINRA contacts the firm and asks that the information be reported or that the firm provide an explanation as to why the information is not reportable. If the firm reports the information on the

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<sup>14</sup> See FINRA Board Approves Amendment to Supervision Rule Requiring Firms to Conduct Background Checks on Registration Applicants, FINRA News Release, April 24, 2014, <http://www.finra.org/Newsroom/NewsReleases/2014/P493588>.

Form U4, FINRA reviews the information and assesses a Disclosure Processing Fee.<sup>15</sup> If the information has not been reported in a timely manner, FINRA also assesses a Late Disclosure Fee.<sup>16</sup>

However, FINRA is proposing to add Supplementary Material .15 to FINRA Rule 3110 to establish a temporary program that will issue a refund to members of Late Disclosure Fees assessed for the late filing of responses to Form U4 Question 14M (unsatisfied judgments or liens) if the following conditions are met: (1) the Form U4 amendment is filed between April 24, 2014 and March 31, 2015; (2) the judgment or lien is under \$5,000 and more than five years old (from the date the judgment or lien is filed with a court as reported on Form U4 Judgment/Lien DRP, Question 4); and (3) the registered person was not employed by, or otherwise associated with, the firm filing the amended Form U4 on the date the judgment or lien was filed with the court. FINRA believes that such a refund would provide members with an additional incentive to report information relating to unsatisfied judgments or liens that are older and of a less significant amount, and it would save FINRA the time and resources expended in contacting firms and requesting that such information be reported. Firms would still be charged a Disclosure Processing Fee (\$110.00) for filing amended Form U4 disclosure information.

As noted above, proposed FINRA Rule 3110.15 has a retroactive effective date of April 24, 2014, and it will automatically sunset on March 31, 2015. Members will not be

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<sup>15</sup> The Disclosure Processing Fee is \$110 for filing amended Form U4 disclosure information.

<sup>16</sup> The Late Disclosure Fee is \$100 for the first day a form filing is late and \$25 for each subsequent day, up to a maximum of \$1,575.

able to use the program after March 31, 2015. FINRA believes that it is appropriate for proposed FINRA Rule 3110.15 to have a retroactive effective date of April 24, 2014 because that is the date that FINRA announced its plan to perform a search of specified public records to verify the accuracy and completeness of specific financial and criminal information reported on the Form U4.

#### IV. Eliminated Rules

NASD Rule 3010(f) requires an applicant for registration to provide, upon a member's request, a copy of his or her Form U5. There is a corresponding provision in NYSE Rule 345.11. FINRA is proposing to eliminate the requirement because members have electronic access to an applicant's Form U5 through the CRD system.

FINRA also is proposing to delete NYSE Rule 345.11 and NYSE Rule Interpretation 345.11/01 and /02 in their entirety as they are substantially similar to proposed FINRA Rule 3110(e), addressed by other rules<sup>17</sup> or otherwise rendered obsolete by the proposed approach reflected in FINRA Rule 3110(e).

##### (b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>18</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public

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<sup>17</sup> FINRA is not proposing to incorporate the requirement of NYSE Rule 345.11 to verify the information contained in the employment questionnaire or application of persons who are not required to be registered because this requirement is redundant of SEA Rule 17a-3(a)(12)(i).

<sup>18</sup> 15 U.S.C. 78q-3(b)(6).

interest. FINRA believes that the proposed rule change will streamline and clarify members' obligations relating to background investigations, which will, in turn, improve members' compliance efforts. Further, the proposed rule change's requirement to adopt written procedures to verify the accuracy and completeness of the information contained in an applicant's Form U4, including the requirement to conduct a public records search, will enhance the accuracy of the information in the CRD system and ultimately in BrokerCheck, which is critical from both a regulatory and an investor protection standpoint. In addition, FINRA believes that the proposed rule change to establish a temporary program under FINRA Rule 3110.15 that will issue a refund to members of Late Disclosure Fees would incentivize members to report information relating to unsatisfied judgments or liens that are older and of a less significant amount and would save FINRA the time and regulatory resources expended in contacting firms and requesting that such information be reported.

**4. Self-Regulatory Organization's Statement on Burden on Competition**

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

FINRA notes that the proposed rule change transfers requirements from NASD Rule 3010(e), NYSE Rule 345.11 and NYSE Rule Interpretation 345.11/01 and /02 unchanged into the Consolidated Rulebook and, as such, those transferred requirements do not impose any new burdens for members that are already subject to the current rules.

The proposed rule change would require members to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information

contained in an applicant's Form U4 no later than 30 calendar days after the form is filed with FINRA, including, at a minimum, procedures to conduct (either directly or through a third-party service provider) a search of reasonably available public records to verify the accuracy and completeness of the information.

FINRA expects that firms already have a review process in place to verify the information contained in the Form U4 for applicants for registration because currently the person signing the form on behalf of the firm must certify that he or she has taken appropriate steps to verify the accuracy and completeness of the information contained in and with that form. Therefore, the requirement to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant's Form U4 should not create an unreasonable burden for members.

With respect to the requirement to conduct a public records search, FINRA is aware that many of the large and mid-size firms already have a review process in place that requires a search of public records,<sup>19</sup> and as a result the proposed rule change would not impose significant burdens on these firms. Further, FINRA does not believe that this requirement would be unduly burdensome for members given the availability of online access to public records databases and the relatively low cost of hiring a third-party service provider to conduct such a search. However, some members would likely incur new costs to comply with the proposed requirement.

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<sup>19</sup> As defined in the FINRA By-Laws, a "large firm" is a member that has 500 or more registered persons and a "mid-size firm" is a member that has at least 151 and no more than 499 registered persons. See FINRA By-Laws, Article I(y) and (cc).



FINRA is aware that many information providers, including the major national credit reporting agencies, provide such public records search services. For instance, as noted above, FINRA has contracted with BIG to provide competitive pricing to members currently at a cost of \$10 to \$13 per applicant (depending on volume) for a public records search. FINRA is providing two sample cost estimates for large, mid-size and small firms<sup>20</sup> using the services of providers such as BIG; one based on the annual average number of applicants for registration, and the other based on the annual average number of pre-hire requests.

FINRA estimates that there are approximately 126,800 applicants for registration each year (based upon the average from the last four years). FINRA estimates that 75 percent of these applicants (approximately 95,100) are from 172 large firms and that 10 percent of these applicants (approximately 12,700) are from 205 mid-size firms. FINRA is aware that many of these large and mid-size firms already have a review process in place that requires a public records search, and as a result the proposed rule change would not impose significant burdens on these firms. FINRA estimates that the remaining 15 percent of applicants (approximately 19,000) are from 2,900 small firms. Based on the per firm average of applicants for registration with large, medium and small firms, FINRA estimates that the average cost of complying with the requirement would be in the range of: (1) \$5,529 to \$7,188 per year for large firms; (2) \$620 to \$805 per year for mid-size firms; and (3) \$66 to \$85 per year for small firms.

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<sup>20</sup> As defined in the FINRA By-Laws, a “small firm” is a member that has at least 1 and no more than 150 registered persons. See FINRA By-Laws, Article I(wv).

FINRA estimates that there are approximately 219,000 pre-hire search requests on the CRD system each year (based upon the average from the last four years). FINRA estimates that 85 percent of the pre-hire checks (approximately 186,400) are from 172 large firms and that 7.5 percent of the pre-hire checks (approximately 16,400) are from 205 mid-size firms. The remaining 7.5 percent (approximately 16,400) are from 1,855 small firms. FINRA notes that these pre-hire check estimates are based on the voluntary checks firms conduct on the CRD system, which are free of charge, and are not the same as the public records search discussed in the proposed rule change. However, to the extent that the number of voluntary pre-hire checks is informative of the anticipated number of public record searches, FINRA estimates that the average annual cost of complying with the requirement would be in the range of: (1) \$10,837 to \$14,088 per firm for large firms; (2) \$800 to \$1,040 per firm for mid-size firms; and (3) \$88 to \$115 per firm for small firms.

FINRA understands that these costs will vary significantly depending on the size of a firm and its registration activity in any given year. In addition, FINRA notes that, in some instances, a public records search may uncover matters that might require further investigation for which the member may incur additional costs.

With respect to the temporary program under proposed FINRA Rule 3110.15, FINRA notes that members currently are required to verify the accuracy and completeness of the information contained in the Form U4 and to amend the form as necessary. The temporary program would encourage members to comply with their existing obligations and allow them to receive a refund of Late Disclosure Fees if the

conditions specified in proposed FINRA Rule 3110.15 are satisfied. As such, FINRA does not believe that the temporary program will result in any burden on members.

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

Written comments were neither solicited nor received.

**6. Extension of Time Period for Commission Action**

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.<sup>21</sup>

**7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)**

Not applicable.

**8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

Not applicable.

**9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act**

Not applicable.

**10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act**

Not applicable.

**11. Exhibits**

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 5. Text of the proposed rule change.

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<sup>21</sup> 15 U.S.C. 78s(b)(2).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. SR-FINRA-2014-038)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 3110(e) (Responsibility of Member to Investigate Applicants for Registration) in the Consolidated FINRA Rulebook

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

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

FINRA is proposing to adopt NASD Rule 3010(e) (Qualifications Investigated) relating to background investigations as FINRA Rule 3110(e) (Responsibility of Member to Investigate Applicants for Registration) in the consolidated FINRA rulebook. The proposed rule change streamlines and clarifies the rule language and adds a provision to require members to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant’s Form U4 (Uniform Application for Securities Industry Registration or Transfer). In addition, the

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

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

proposed rule change adds Supplementary Material .15 (Temporary Program to Address Underreported Form U4 Information) to FINRA Rule 3110 (Supervision) to establish a temporary program that will issue a refund to members of Late Disclosure Fees assessed for the late filing of responses to Form U4 Question 14M, subject to specified conditions.

The proposed rule change would delete NASD Rule 3010(f) (Applicant's Responsibility), Incorporated NYSE Rule 345.11 (Investigation and Records) and Incorporated NYSE Rule Interpretation 345.11/01 (Application – Investigation) and /02 (Application – Records).

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

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

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

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

1. Purpose

As part of the process of developing a new consolidated rulebook ("Consolidated

FINRA Rulebook”),<sup>3</sup> FINRA is proposing to adopt NASD Rule 3010(e) relating to background investigations as FINRA Rule 3110(e). The proposed rule change streamlines and clarifies the rule language. In addition, the proposed rule change adds a provision to proposed FINRA Rule 3110(e) to require members to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant’s Form U4 as described below. Further, the proposed rule change adds Supplementary Material .15 to FINRA Rule 3110 to establish a temporary program that will issue a refund to members of Late Disclosure Fees assessed for the late filing of responses to Form U4 Question 14M, subject to specified conditions.

The proposed rule change would delete NASD Rule 3010(f) because it has been rendered obsolete. The proposed rule change would also delete Incorporated NYSE Rule 345.11<sup>4</sup> and NYSE Rule Interpretation 345.11/01 and /02 as they are substantially similar to proposed FINRA Rule 3110(e), addressed by other rules or otherwise rendered obsolete by the proposed approach reflected in FINRA Rule 3110(e).

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

<sup>4</sup> For convenience, the proposed rule change refers to Incorporated NYSE Rules as NYSE Rules.

I. Existing Requirements

A critical part of the registration process in the securities industry is the background investigation of applicants for registration and the timely and accurate reporting of information to the Central Registration Depository (CRD®) system via the Form U4. For instance, FINRA reviews the information disclosed on the Form U4 to determine whether an applicant is subject to a statutory disqualification<sup>5</sup> or whether the applicant may present a regulatory risk for the firm and customers. Further, firms use the information reported to the CRD system to determine whether an applicant is subject to a statutory disqualification and to conduct background checks on applicants when making registration decisions. In addition, the information that FINRA releases to the public through BrokerCheck, which helps investors make informed choices about the individuals and firms with which they conduct business, is derived from the CRD system.

NASD Rule 3010(e) provides that a firm must ascertain by investigation the good character, business reputation, qualifications and experience of an applicant before the firm applies to register that applicant with FINRA.<sup>6</sup> NASD Rule 3010(e) does not place any limits on the scope of such a background investigation – a firm must obtain all the necessary information to make an evaluation.<sup>7</sup> In addition, if the applicant previously has

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<sup>5</sup> See Sections 3(a)(39) and 15(b)(4) of the Act.

<sup>6</sup> Firms must comply with MSRB Rule G-7 (Information Concerning Associated Persons) regarding those applicants engaged solely in municipal securities activities.

<sup>7</sup> FINRA has stated that firms should consider all available information gathered in the pre-registration process for this purpose, including, but not limited to Forms U4 and U5 responses, authorized searches of the CRD system, fingerprint results obtained under SEA Rule 17f-2 and communications with previous employers, and that firms also may wish to consider private background checks, credit reports and reference letters. See Regulatory Notice 07-55 (November 2007). In

been registered with FINRA, NASD Rule 3010(e) specifically requires that the firm review a copy of the applicant's most recent Form U5 (Uniform Termination Notice for Securities Industry Registration) within 60 days of the filing date of an application for registration or demonstrate that it has made reasonable efforts to do so.<sup>8</sup>

NYSE Rule 345.11, which is the corresponding NYSE rule, requires firms to investigate thoroughly the previous record of: (1) persons required to be registered with the NYSE; (2) persons who regularly handle or process securities or monies or maintain the books and records relating to securities or monies who are not otherwise required to be registered; and (3) persons having direct supervisory responsibility over persons engaged in the above activities who are not otherwise required to be registered.<sup>9</sup> For persons required to be registered with the NYSE, firms generally fulfill their investigative obligation by verifying the information contained in the Form U4 and by reviewing the applicant's most recent Form U5, if the applicant previously has been registered. For persons subject to NYSE Rule 345.11 who are not required to be registered, firms generally fulfill their investigative obligation by verifying the information contained in

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addition, FINRA has stated that firms must ensure that such background investigations are conducted in accordance with all applicable laws, rules and regulations (including federal and state requirements) and that all necessary approvals, consents and authorizations have been obtained. See Regulatory Notice 07-55.

<sup>8</sup> If the applicant has been recently employed by a Futures Commission Merchant or an Introducing Broker that is notice-registered with the SEC pursuant to Section 15(b)(11) of the Act, the registering firm also is required to review a copy of the individual's most recent CFTC Form 8-T.

<sup>9</sup> See also NYSE Rule Interpretation 345.11/01 and /02.



the employment questionnaire or application required under SEA Rule 17a-3(a)(12)(i).<sup>10</sup> NYSE Rule 345.11 also requires firms to make further inquiry, where appropriate, in light of the background information developed, the position for which the person is being considered or other circumstances.

The Form U4 requires that the person signing the form on behalf of the firm certify that he or she has taken appropriate steps to verify the accuracy and completeness of the information contained in and with that form.<sup>11</sup>

## II. Proposed FINRA Rule 3110(e)

FINRA is proposing to amend FINRA Rule 3110 by adding a new paragraph (e) and incorporating the requirements of NASD Rule 3010(e) into that paragraph, subject to the following changes.

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<sup>10</sup> SEA Rule 17a-3(a)(12)(i) requires that a broker-dealer make and keep current a questionnaire or application for employment executed by each associated person, other than persons whose functions are solely clerical or ministerial. The questionnaire or application must be approved in writing by an authorized representative and must, among other information, contain the associated person's employment, disciplinary and criminal history. If an associated person is a registered person of the broker-dealer, then retention of a full, correct and complete copy of the associated person's originally executed Form U4 for registration with FINRA or other regulatory agency is sufficient to satisfy this requirement.

<sup>11</sup> The Form U4 also provides that the person signing the form on behalf of the firm certify that the firm has communicated with the applicant's previous employers for the past three years and has documentation on file with the names of the persons contacted and the date of contact. In addition, members have an obligation to comply with SEA Rule 17f-2. Pursuant to SEA Rule 17f-2, specific persons employed in the securities industry are required to be fingerprinted for purposes of a criminal background check. Firms are responsible for obtaining a prospective employee's fingerprints and required identifying information. Firms then submit the prospective employee's fingerprints together with the required identifying information to FINRA. FINRA, in turn, submits these fingerprints to the FBI. FINRA also makes the fingerprint results available to the employing member and regulators, consistent with applicable federal laws and FBI and FINRA requirements. See Notice to Members 05-39 (May 2005).

FINRA is proposing to streamline and clarify the rule language. For instance, NASD Rule 3010(e) currently provides that “[e]ach member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making such a certification in the application of such person for registration with this Association,” whereas proposed FINRA Rule 3110(e) provides that “[e]ach member shall ascertain by investigation the good character, business reputation, qualifications and experience of an applicant before the member applies to register that applicant with FINRA and before making a representation to that effect on the application for registration.” Further, proposed FINRA Rule 3110(e) clarifies that a firm is required to review a copy of an applicant’s most recent Form U5 if the applicant previously has been registered with FINRA or another self-regulatory organization. With respect to a firm’s obligation to review an applicant’s Form U5, the proposed rule continues to provide that if the firm is unable to review the Form U5, it has to demonstrate that it has made reasonable efforts to do so. FINRA expects firms to use this provision in very limited circumstances, such as where the previous firm fails to file a Form U5 or goes out of business before filing a Form U5. FINRA also is proposing to re-label current FINRA Rule 3110(e) (Definitions) as FINRA Rule 3110(f) (Definitions) and update the cross-references in FINRA Rule 3110 to reflect this change.

In addition, FINRA is proposing to include in proposed FINRA Rule 3110(e) a requirement that firms adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant’s Form U4 no later than 30 calendar days after the form is filed with FINRA. FINRA believes that such a requirement is consistent with the requirements of NYSE Rule 345.11 and the Form

U4. The proposed requirement would only apply to an initial or a transfer Form U4 for an applicant for registration, and not to Form U4 amendments. FINRA further believes that imposing such a requirement would not be unduly burdensome for firms; FINRA expects that firms already have a review process in place to verify the information contained in the Form U4 for most applicants for registration.

Proposed FINRA Rule 3110(e) would also require that a firm's written procedures must, at a minimum, provide for a search of reasonably available public records<sup>12</sup> conducted by the member or a third-party service provider to verify the accuracy and completeness of the information contained in an applicant's Form U4.<sup>13</sup> The requirement to conduct a public records search must be satisfied no later than 30 calendar days after the initial or transfer Form U4 is filed with FINRA, with the understanding that if a member becomes aware of any discrepancies as a result of a public records search conducted after the filing of the Form U4, the member would be required to file an amended Form U4 with FINRA. As discussed in more detail below, FINRA does not believe that this requirement would be unduly burdensome for members given the availability of online access to public records databases and the relatively low cost of hiring a third-party service provider to conduct such a search. Therefore, this requirement would provide firms with a relatively low cost method to verify that all disclosure events evidenced in reasonably available public records have been reported on the Form U4. In addition, FINRA is aware that many firms already have a review

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<sup>12</sup> Public records include, but are not limited to: general information, such as name and address of individuals; criminal records; bankruptcy records; civil litigations and judgments; liens; and business records.

<sup>13</sup> The requirement to conduct a public records search would be limited to a national search; it would not extend to public records searches in foreign jurisdictions.

process in place that entails searching public records, and therefore the proposed requirement will not impose significant burdens on these firms.

A member could comply with the requirement to conduct a public records search in several ways. For example, a member may satisfy the requirement by: (1)(a) reviewing a credit report from a major national credit reporting agency that contains public record information (such as bankruptcies, judgments and liens), or (b) searching a reputable national public records database; and (2) reviewing the fingerprint results obtained as part of the registration process. Alternatively, a member could comply with this requirement by using the services of a specialized provider, such as Business Information Group, Inc. (BIG),<sup>14</sup> to provide the firm with a consolidated report of a national public records search, which includes a search of financial and criminal public records. A member may find it necessary to conduct a more in-depth search of an applicant's background depending on the applicant's job function, responsibilities or position at the firm.

FINRA encourages firms to conduct the required public records search prior to filing the initial or transfer Form U4 to avoid the fees associated with filing a Form U4 amendment. In addition, FINRA recognizes that there will on occasion be circumstances beyond a firm's control that prevent completion of the verification process within 30 calendar days after the Form U4 is filed with FINRA. For example, where a firm is relying on fingerprint results for purposes of a criminal public records search, and the

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<sup>14</sup> FINRA has contracted with BIG to provide competitive pricing to members that are conducting background investigations of applicants, currently at a cost of \$10 to \$13 per applicant (depending on volume). In general, FINRA does not endorse any particular third-party service and a firm's use of BIG's services, or the services of any other specific provider, would not be deemed to be a safe harbor by FINRA.

FBI determines the fingerprints to be “illegible” and requires resubmission of the fingerprints. In such circumstances, the firm’s procedures should provide that the verification should be completed as soon as is practical.

FINRA is proposing to implement proposed FINRA Rule 3110(e) on December 1, 2014, which coincides with the implementation date for the consolidated FINRA supervision rules. FINRA will announce the effective date of proposed FINRA Rule 3110(e) in a Regulatory Notice to be published no later than 90 days following Commission approval.

### III. Proposed FINRA Rule 3110.15

As announced by FINRA on April 24, 2014, to verify against public records whether material financial information has been timely and accurately reported to the CRD system via the Form U4, FINRA is performing a one-time search of specific financial public records, including bankruptcies, judgments and liens, on all registered persons.<sup>15</sup> In addition, as part of this effort and to verify against public records whether material criminal information has been accurately reported to the CRD system via the Form U4, FINRA is performing an ongoing search of specific criminal public records on a risk-based basis and on any registered person who has not been fingerprinted within the past five years. FINRA is using one or more national information providers in the conduct of these reviews. The reviews are performed against readily available, online public records.

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<sup>15</sup> See FINRA Board Approves Amendment to Supervision Rule Requiring Firms to Conduct Background Checks on Registration Applicants, FINRA News Release, April 24, 2014, <http://www.finra.org/Newsroom/NewsReleases/2014/P493588>.

In the course of these reviews, if FINRA identifies instances where required information has not been reported to the CRD system via the Form U4, FINRA contacts the firm and asks that the information be reported or that the firm provide an explanation as to why the information is not reportable. If the firm reports the information on the Form U4, FINRA reviews the information and assesses a Disclosure Processing Fee.<sup>16</sup> If the information has not been reported in a timely manner, FINRA also assesses a Late Disclosure Fee.<sup>17</sup>

However, FINRA is proposing to add Supplementary Material .15 to FINRA Rule 3110 to establish a temporary program that will issue a refund to members of Late Disclosure Fees assessed for the late filing of responses to Form U4 Question 14M (unsatisfied judgments or liens) if the following conditions are met: (1) the Form U4 amendment is filed between April 24, 2014 and March 31, 2015; (2) the judgment or lien is under \$5,000 and more than five years old (from the date the judgment or lien is filed with a court as reported on Form U4 Judgment/Lien DRP, Question 4); and (3) the registered person was not employed by, or otherwise associated with, the firm filing the amended Form U4 on the date the judgment or lien was filed with the court. FINRA believes that such a refund would provide members with an additional incentive to report information relating to unsatisfied judgments or liens that are older and of a less significant amount, and it would save FINRA the time and resources expended in contacting firms and requesting that such information be reported. Firms would still be

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<sup>16</sup> The Disclosure Processing Fee is \$110 for filing amended Form U4 disclosure information.

<sup>17</sup> The Late Disclosure Fee is \$100 for the first day a form filing is late and \$25 for each subsequent day, up to a maximum of \$1,575.

charged a Disclosure Processing Fee (\$110.00) for filing amended Form U4 disclosure information.

As noted above, proposed FINRA Rule 3110.15 has a retroactive effective date of April 24, 2014, and it will automatically sunset on March 31, 2015. Members will not be able to use the program after March 31, 2015. FINRA believes that it is appropriate for proposed FINRA Rule 3110.15 to have a retroactive effective date of April 24, 2014 because that is the date that FINRA announced its plan to perform a search of specified public records to verify the accuracy and completeness of specific financial and criminal information reported on the Form U4.

#### IV. Eliminated Rules

NASD Rule 3010(f) requires an applicant for registration to provide, upon a member's request, a copy of his or her Form U5. There is a corresponding provision in NYSE Rule 345.11. FINRA is proposing to eliminate the requirement because members have electronic access to an applicant's Form U5 through the CRD system.

FINRA also is proposing to delete NYSE Rule 345.11 and NYSE Rule Interpretation 345.11/01 and /02 in their entirety as they are substantially similar to proposed FINRA Rule 3110(e), addressed by other rules<sup>18</sup> or otherwise rendered obsolete by the proposed approach reflected in FINRA Rule 3110(e).

#### 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of

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<sup>18</sup> FINRA is not proposing to incorporate the requirement of NYSE Rule 345.11 to verify the information contained in the employment questionnaire or application of persons who are not required to be registered because this requirement is redundant of SEA Rule 17a-3(a)(12)(i).

Section 15A(b)(6) of the Act,<sup>19</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will streamline and clarify members' obligations relating to background investigations, which will, in turn, improve members' compliance efforts. Further, the proposed rule change's requirement to adopt written procedures to verify the accuracy and completeness of the information contained in an applicant's Form U4, including the requirement to conduct a public records search, will enhance the accuracy of the information in the CRD system and ultimately in BrokerCheck, which is critical from both a regulatory and an investor protection standpoint. In addition, FINRA believes that the proposed rule change to establish a temporary program under FINRA Rule 3110.15 that will issue a refund to members of Late Disclosure Fees would incentivize members to report information relating to unsatisfied judgments or liens that are older and of a less significant amount and would save FINRA the time and regulatory resources expended in contacting firms and requesting that such information be reported.

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

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

FINRA notes that the proposed rule change transfers requirements from NASD Rule 3010(e), NYSE Rule 345.11 and NYSE Rule Interpretation 345.11/01 and /02

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<sup>19</sup> 15 U.S.C. 78q-3(b)(6).



unchanged into the Consolidated Rulebook and, as such, those transferred requirements do not impose any new burdens for members that are already subject to the current rules.

The proposed rule change would require members to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant's Form U4 no later than 30 calendar days after the form is filed with FINRA, including, at a minimum, procedures to conduct (either directly or through a third-party service provider) a search of reasonably available public records to verify the accuracy and completeness of the information.

FINRA expects that firms already have a review process in place to verify the information contained in the Form U4 for applicants for registration because currently the person signing the form on behalf of the firm must certify that he or she has taken appropriate steps to verify the accuracy and completeness of the information contained in and with that form. Therefore, the requirement to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant's Form U4 should not create an unreasonable burden for members.

With respect to the requirement to conduct a public records search, FINRA is aware that many of the large and mid-size firms already have a review process in place that requires a search of public records,<sup>20</sup> and as a result the proposed rule change would not impose significant burdens on these firms. Further, FINRA does not believe that this requirement would be unduly burdensome for members given the availability of online

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<sup>20</sup> As defined in the FINRA By-Laws, a "large firm" is a member that has 500 or more registered persons and a "mid-size firm" is a member that has at least 151 and no more than 499 registered persons. See FINRA By-Laws, Article I(y) and (cc).

access to public records databases and the relatively low cost of hiring a third-party service provider to conduct such a search. However, some members would likely incur new costs to comply with the proposed requirement.

FINRA is aware that many information providers, including the major national credit reporting agencies, provide such public records search services. For instance, as noted above, FINRA has contracted with BIG to provide competitive pricing to members currently at a cost of \$10 to \$13 per applicant (depending on volume) for a public records search. FINRA is providing two sample cost estimates for large, mid-size and small firms<sup>21</sup> using the services of providers such as BIG; one based on the annual average number of applicants for registration, and the other based on the annual average number of pre-hire requests.

FINRA estimates that there are approximately 126,800 applicants for registration each year (based upon the average from the last four years). FINRA estimates that 75 percent of these applicants (approximately 95,100) are from 172 large firms and that 10 percent of these applicants (approximately 12,700) are from 205 mid-size firms. FINRA is aware that many of these large and mid-size firms already have a review process in place that requires a public records search, and as a result the proposed rule change would not impose significant burdens on these firms. FINRA estimates that the remaining 15 percent of applicants (approximately 19,000) are from 2,900 small firms. Based on the per firm average of applicants for registration with large, medium and small firms, FINRA estimates that the average cost of complying with the requirement would be in

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<sup>21</sup> As defined in the FINRA By-Laws, a “small firm” is a member that has at least 1 and no more than 150 registered persons. See FINRA By-Laws, Article I(ww).

the range of: (1) \$5,529 to \$7,188 per year for large firms; (2) \$620 to \$805 per year for mid-size firms; and (3) \$66 to \$85 per year for small firms.

FINRA estimates that there are approximately 219,000 pre-hire search requests on the CRD system each year (based upon the average from the last four years). FINRA estimates that 85 percent of the pre-hire checks (approximately 186,400) are from 172 large firms and that 7.5 percent of the pre-hire checks (approximately 16,400) are from 205 mid-size firms. The remaining 7.5 percent (approximately 16,400) are from 1,855 small firms. FINRA notes that these pre-hire check estimates are based on the voluntary checks firms conduct on the CRD system, which are free of charge, and are not the same as the public records search discussed in the proposed rule change. However, to the extent that the number of voluntary pre-hire checks is informative of the anticipated number of public record searches, FINRA estimates that the average annual cost of complying with the requirement would be in the range of: (1) \$10,837 to \$14,088 per firm for large firms; (2) \$800 to \$1,040 per firm for mid-size firms; and (3) \$88 to \$115 per firm for small firms.

FINRA understands that these costs will vary significantly depending on the size of a firm and its registration activity in any given year. In addition, FINRA notes that, in some instances, a public records search may uncover matters that might require further investigation for which the member may incur additional costs.

With respect to the temporary program under proposed FINRA Rule 3110.15, FINRA notes that members currently are required to verify the accuracy and completeness of the information contained in the Form U4 and to amend the form as necessary. The temporary program would encourage members to comply with their

existing obligations and allow them to receive a refund of Late Disclosure Fees if the conditions specified in proposed FINRA Rule 3110.15 are satisfied. As such, FINRA does not believe that the temporary program will result in any burden on members.

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

Written comments were neither solicited nor received.

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

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

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

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

IV. Solicitation of Comments

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2014-038 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2014-038. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2014-038 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>22</sup>

Brent J. Fields

Secretary

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<sup>22</sup> 17 CFR 200.30-3(a)(12).

**EXHIBIT 5**

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.<sup>1</sup>

\* \* \* \* \*

**Text of Proposed New FINRA Rule 3110(e)**

\* \* \* \* \*

**3000. SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS**

**3100. SUPERVISORY RESPONSIBILITIES**

**3110. Supervision**

**(a) Supervisory System**

Each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(1) through (2) No Change.

(3) The registration and designation as a branch office or an office of supervisory jurisdiction (OSJ) of each location, including the main office, that meets the definitions contained in paragraph [(e)](f) of this Rule.

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<sup>1</sup> The text of FINRA Rule 3110 is shown to include the amendments approved by the Commission in SR-FINRA-2013-025. See Securities Exchange Act Release No. 71179 (December 23, 2013), 78 FR 79542 (December 30, 2013). FINRA Rule 3110 will become effective on December 1, 2014. See also Regulatory Notice 14-10 (March 2014).

(4) through (7) No Change.

(b) through (d) No Change.

**(e) Responsibility of Member to Investigate Applicants for Registration**

Each member shall ascertain by investigation the good character, business reputation, qualifications and experience of an applicant before the member applies to register that applicant with FINRA and before making a representation to that effect on the application for registration.

If the applicant previously has been registered with FINRA or another self-regulatory organization, the member shall review a copy of the applicant's most recent Form U5, including any amendments thereto, within 60 days of the filing date of an application for registration, or demonstrate to FINRA that it has made reasonable efforts to do so. In conducting its review of the Form U5, the member shall take such action as may be deemed appropriate.

The member shall also review an applicant's employment experience to determine if the applicant has been recently employed by a Futures Commission Merchant or an Introducing Broker that is notice-registered with the SEC pursuant to Section 15(b)(11) of the Exchange Act. In such a case, the member shall also review a copy of the applicant's most recent CFTC Form 8-T, including any amendments thereto, within 60 days of the filing date of an application for registration, or demonstrate to FINRA that it has made reasonable efforts to do so. In conducting its review of a Form 8-T, the member shall take such action as may be deemed appropriate.

In addition, each member shall establish and implement written procedures reasonably designed to verify the accuracy and completeness of the information



contained in an applicant's Form U4 no later than 30 calendar days after the form is filed with FINRA. Such procedures shall, at a minimum, provide for a search of reasonably available public records to be conducted by the member, or a third-party service provider, to verify the accuracy and completeness of the information contained in the applicant's Form U4.

**[(e)](f) Definitions**

(1) No Change.

(2) (A) through (B) No Change.

(C) The term "business day" as used in paragraph [(e)](f)(2)(A) of this Rule shall not include any partial business day provided that the associated person spends at least four hours on such business day at his or her designated branch office during the hours that such office is normally open for business.

**••• Supplementary Material: -----**

**.01 Registration of Main Office.** A member's main office location is required to be registered and designated as a branch office or OSJ if it meets the definitions of a "branch office" or "office of supervisory jurisdiction" as set forth in Rule 3110[(e)](f). In general, the nature of activities conducted at a main office will satisfy the requirements of such terms.

**.02 Designation of Additional OSJs.** In addition to the locations that meet the definition of OSJ in Rule 3110[(e)](f), each member shall also register and designate other offices as OSJs as is necessary to supervise its associated persons in accordance

with the standards set forth in Rule 3110. In making a determination as to whether to designate a location as an OSJ, the member should consider the following factors:

(a) through (e) No Change.

.03 through .14 No Change.

**.15 Temporary Program to Address Underreported Form U4 Information. FINRA**

is establishing a temporary program that will issue a refund to members of Late Disclosure Fees assessed for the late filing of responses to Form U4 Question 14M (unsatisfied judgments or liens) if the following conditions are met: (1) the Form U4 amendment is filed between April 24, 2014 and March 31, 2015; (2) the judgment or lien is under \$5,000 and more than five years old (from the date the judgment or lien is filed with a court as reported on Form U4 Judgment/Lien DRP, Question 4); and (3) the registered person was not employed by, or otherwise associated with, the firm filing the amended Form U4 on the date the judgment or lien was filed with the court. This program has a retroactive effective date of April 24, 2014, and it will automatically sunset on March 31, 2015. Members will not be able to use the program after March 31, 2015.

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\* No Change.

\* \* \* \* \*

**Text of NASD Rule  
to be Deleted in its Entirety from the Transitional Rulebook**

\* \* \* \* \*

**[3010. Supervision]**

**Entire text deleted.**

\* \* \* \* \*

**Text of Incorporated NYSE Rule and Incorporated NYSE Rule Interpretation  
to Remain in the Transitional Rulebook**

\* \* \* \* \*

**Incorporated NYSE Rule**

\* \* \* \* \*

**Rule 345. Employees—Registration, Approval, Records**

(a) No Change.

**• • • Supplementary Material -----**

**Registration of Employees**

**.10** No Change.

**.11 [Investigation and Records] Reserved.**

[(a) Members and member organizations shall thoroughly investigate the previous record of persons whom they contemplate employing including, (1) persons required to be registered with the Exchange, (2) persons who regularly handle or process securities or monies or maintain the books and records relating to securities or monies and (3) persons having direct supervisory responsibility over persons engaged in the activities referred to in (1) and (2) above who are not otherwise required to be registered.]

[Investigatory requirements for persons required to be registered with the Exchange (referred to in (a)(1) above) shall be satisfied when the member or member organization fulfills its obligation to verify the information contained in

the Uniform Application for Securities Industry Registration or Transfer (Form U-4) and reviews the most recent Form U-5, as described below, if applicable.]

[In addition, a member or member organization shall obtain from an applicant, if applicable, a copy of his or her Uniform Termination Notice of Securities Industry Registration (Form U-5) and any amendments filed thereto, by the most recent employer. A member or member organization shall request said Form U-5 from any person who was previously registered with the Exchange or other self-regulatory organization that requires its members to provide a copy of Form U-5 to its terminated registered persons. (See also Rule 345.17.)]

[The member or member organization shall obtain said Form U-5 no later than sixty (60) days following the filing of the application for registration or demonstrate to the Exchange that it has made reasonable efforts to comply with the requirement. A member or member organization receiving a Form U-5 pursuant to this provision shall review the Form U-5 and any amendment thereto as part of its investigatory process and shall take such action as may be deemed appropriate.]

[Investigatory requirements pertaining to persons specified in (a)(2) and (3) above shall be satisfied if a member or member organization verifies the information obtained pursuant to paragraph (c) below. Notwithstanding the above, further inquiry shall be made where appropriate in light of background information developed, the position for which the person is being considered or other circumstances. Investigation and verification shall be done by a member or person designated under the provisions of Rule 342(b)(1).]

[(b) Any applicant for registration who receives a request for a copy of his or her Form U-5 from a member or member organization pursuant to (a) above shall provide such copy to the member or member organization within two (2) business days of the request if the Form U-5 has been provided to such person by his or her former employer. If an employer has failed to provide the Form U-5 to the applicant for registration, such person shall promptly request the Form U-5, and shall provide it to the requesting member or member organization within two (2) business days of receipt thereof. The applicant shall promptly provide any subsequent amendments to a Form U-5 he or she receives to the requesting member or member organization.]

[(c) Members and member organizations are reminded to obtain and keep on file all information required under Rule 17a-3(a)(12) of the Securities Exchange Act of 1934 for persons included within the definition of “associated person” pursuant to Rule 17a-3(a)(12)(ii). In addition, the Exchange requires that a record be kept of whether a bonding company has ever denied or revoked, or paid out on any bond because of such person.]

[If an employee is registered with the Exchange, a duplicated copy of Form U-4 signed by an authorized person shall satisfy all the recordkeeping requirements of this paragraph.]

.12 through .16 No Change.

### **General Information Regarding Employees**

.17 through .18 No Change.

\* \* \* \* \*

**Incorporated NYSE Rule Interpretation**

\* \* \* \* \*

**Rule 345 Employees — Registration, Approval, Records**

(a) through (b) No Change.

.11 [INVESTIGATION AND RECORDS] Reserved.

[/01 Application — Investigation]

[Member organizations must investigate the previous record of persons whom they contemplate employing including, (1) persons required to be registered with the Exchange, (2) persons who regularly have access to the keeping, handling or processing of securities, monies or the original books and records relating to securities or monies and (3) persons having direct supervisory responsibility over persons engaged in the activities referred to in (1) and (2) above.]

[Investigatory requirements for persons required to be registered with the Exchange (referred to in (1) above) will be satisfied when the member organization fulfills its obligation to verify the information contained in the Uniform Application for Securities Industry Registration Or Transfer (Form U4). Similarly, investigatory requirements pertaining to persons specified in (2) and (3) above shall be satisfied if a member organization verifies the information obtained pursuant to SEA Rule 17a-3(a)(12). (See /02 below.) Notwithstanding the above, further inquiry must be made where appropriate in light of background information developed, the position for which the person is being considered or other circumstances.]

[For those persons a member organization contemplates employing who are not specifically required to be investigated, a member organization should tailor its investigation in a manner it deems appropriate in light of the position to be held by such person. (See also Rule 346(f) regarding persons subject to “statutory disqualifications”).]

[/02 Application — Records]

[Member organizations are reminded to obtain and keep on file all information required under SEA Rule 17a-3(a)(12) for persons included within the definition of “associated person” (see Rule 17a-3(a)(12)(ii)). Further, the Exchange requires that a record be kept of whether a bonding company has ever denied or revoked, or paid out on any bond because of such person.]

[For persons required to be registered with the Exchange, a duplicate copy of Form U4 signed by an authorized person will satisfy all the recordkeeping requirements of NYSE Rule 345.11.]

.12 No Change.

.15 No Change.

.18 No Change.

\* \* \* \* \*