



July 30, 2010

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

**Re: FINRA Regulatory Notice 10-25 (Registration and Qualification Requirements for Certain Operations Personnel)**

Dear Ms. Asquith:

This letter is submitted on behalf of the National Society of Compliance Professionals Inc. (“NSCP”) in response to the publication of Regulatory Notice 10-25 (hereafter referred to as the "Notice" or the "Proposal"), which proposes the creation of a registration category, qualification examination and continuing education requirements for certain operations personnel (hereafter referred to as “Operations Professionals”).<sup>1</sup> We appreciate the opportunity to provide our comments on this important Proposal.

Our comments reflect NSCP’s fundamental mission, which is to set the standard for excellence in the securities compliance profession. This commitment is exemplified, among other things, by the time and resources NSCP, and the industry professionals whose volunteer services it marshals, have devoted in the past three years to the development of a voluntary certification and examination program for compliance professionals.<sup>2</sup>

Our mission is directed at the interests of compliance programs and compliance officers. We accordingly support a regulatory scheme that: (i) promotes practices that support market integrity and the interests of investors; (ii) creates clarity as to a firm’s obligations to provide a reasonable system of supervision; (iii) promotes requirements that enable compliance officers to create reasonably workable programs; and (iv) avoids requirements or mandated tasks that are more costly or less efficient in realizing a regulator’s public policy objectives, thereby increasing the difficulty facing a compliance officer in the discharge of his or her duties.

---

<sup>1</sup> NSCP is a non-profit membership organization made up of approximately 1800 securities industry professionals committed to developing education initiatives and practical solutions to compliance-related issues.

<sup>2</sup> Persons who complete the NSCP’s program qualify for the “Certified Securities Compliance Professional” designation.

While we appreciate that recent conduct in the marketplace has given rise to the SEC's interest in this Proposal, and concur with FINRA's objective of ensuring "that investor protection mechanisms are in place in all areas of a member firm's business that could harm a customer, a firm, the integrity of the marketplace or the public" by enhancing "the regulatory structure surrounding a member firm's back-office operation," we believe that certain provisions of the Proposal should be revised to clarify its applicability, eliminate unnecessary costs, burdens and unintended consequences, and improve its overall effectiveness in achieving FINRA's goal.

As discussed in greater detail below, the examination requirement will have a substantial (in some cases life changing) impact on firms and individuals. Because this impact should not, and can not be taken lightly, FINRA must strive to focus the requirement as clearly and narrowly as possible while still achieving its intended objective. Our recommendations reflect this desired outcome. We focus our comments on several major themes. First, we believe that FINRA should carefully evaluate the objectives and consequences of the new testing requirement on potential test takers and consider increasing its reliance on internal firm element training to deliver a portion of the required content. Second, we suggest that the class of persons subject to the requirement be refined. Finally, we suggest clarifying and limiting the scope of the Proposal's covered functions.

**The Qualification Examination, Which Will be Challenging for Many Test Takers, Must Not Become a De Facto "Competency" Exam. We Recommend that Firm Element Training be Utilized to Deliver the Proposed Product, Market and Operations Knowledge Content.**

The Notice identifies three broad areas of content intended to be covered by the proposed examination. First, the Notice provides that the examination is intended to be "a single principles-based qualification examination with a regulatory focus to test for a broad understanding of a broker-dealer's business at a basic level." In this vein, the exam is intended to: (i) address "key regulatory and control themes" and (ii) assure that registrants "understand their professional responsibilities" including those relating to the escalation of "red flags that may harm a firm, its customers, the integrity of the marketplace or the public." The Notice states emphatically that the exam is not intended to be a competency exam, and is to "test for general securities industry knowledge with a regulatory focus."

The Notice also provides, however, for two additional substantive areas of exam coverage: "essential product and market knowledge for an Operations Professional;" and "knowledge associated with operations activities." We are concerned that the inclusion of these latter two categories will inevitably undercut FINRA's premise that the exam is not intended to be "competency" examination. Such a comprehensive "competency" examination will be overly-broad and extremely difficult for some Operations Professionals to pass as they will not have had the adequate background or experience to serve as a knowledge base for successful completion of the exam. The list of covered functions provided in the Notice shows just how broad and diverse the job functions are that are performed by back-office personnel. In this regard, while the categories of knowledge enumerated in the rule proposal look to be meaningful, and should generally be familiar to, many if not most managers in traditional back-office operations functions, they may be largely unrelated to a number of the covered functions that fall outside of

traditional back office roles. For example, professionals charged with developing structured product valuation models or IT security requirements would have no particular reason to be aware of most, if not all, of the specified areas of substantive exam content cited in the Notice (“customer account set-up rules and transfers, recordkeeping requirements, rules associated with the protection of customer assets and transaction processing, uniform practices associated with making good delivery of securities, making payments for securities and meeting settlement requirements, [or] credit and margin rules”). Information that would constitute “essential product and market knowledge” for someone responsible for the “development and approval of pricing models used for valuations” (which would typically be a fixed income or structured products professional) would differ strikingly from that required for a person overseeing “client onboarding (customer account data and document maintenance)” or someone “approving business security requirements and policies for information technology.” No one has suggested (or indeed could reasonably suggest) that any one person performs more than a few of these functions. Even at the supervisory level, oversight of these functions is typically fairly specialized, especially at large firms. The result of such diversity and specialization is that any test that attempts to cover the plethora of functions will either be watered-down in an attempt to ensure an appropriate passing rate, or will be too difficult; (i) rewarding the applicants who are good test-takers, able to absorb large quantities of information unrelated to their day-to-day jobs and retain it long enough to pass a test, while (ii) penalizing other applicants with appropriate ethical grounding and sound training for their current jobs who are less proficient at digesting and using information in a test setting. In short, we have serious reservations regarding the content of the test, and whether it makes sense to try to develop a “one size fits all” examination test for persons who are responsible for supervising such highly varied tasks as stock loan authorizations, securities valuations, client account approvals, business security requirements, segregation, custody and control activities and all the other functions that come within the rubric of “back-office” functions.

While we recognize that a qualifications examination has historically been a part of licensing and registration, we urge FINRA to carefully consider the unique circumstances that will apply to the audience taking this exam. Particularly in the operations space, where many employees have gained valuable experience on the job, many of the managers who would be captured by this examination requirement have never been subjected to a professional qualification test, and in fact will not have been asked to complete a test of any sort since high school or college graduation, which may have occurred decades in the past. If the examination is not carefully crafted, there is a risk that otherwise well qualified employees may be rendered ineligible for continued service because of challenges taking and passing the examination.

Such a result could create risk to a firm’s otherwise healthy system of operations and supervision. Individuals who do not pass the test are likely to be released from their jobs or, at best, demoted, irrespective of many years of exemplary service, a lack of any disciplinary history, and consistent performance in accordance with the highest ethical standards. This potential scenario presents the risk of a significant back-office “brain drain” of highly worthy, qualified persons from the industry. Such a result would not only undermine FINRA’s goal of protecting investors and the marketplace by ensuring experienced operations personnel are in place, it would also present a monumental set back many firms would find extraordinarily difficult to recover from.

We believe that the objectives underlying the registration requirement would be best served with a limited principles based exam to test for “general securities knowledge with a regulatory focus” and covering professional conduct and ethical considerations. The two additional, substantive areas of proposed exam coverage: “essential product and market knowledge for an Operations Professional” and “knowledge associated with operations activities” should be eliminated from the examination curriculum as the inclusion of these latter two categories will inevitably undercut FINRA’s premise that it will not become a “competency” examination and render the test extremely challenging for many Operations Professionals to pass.

It is our view that such substantive areas would be better covered as part of a firm’s existing Rule 1120 obligations to provide continuing firm element education. Such firm element training would better target training to the employee’s particular function in the firm and could include firm specific processes. In our opinion, this would improve the quality of the training that Operations Professionals would receive and focus the testing requirement on those issues truly germane to the concerns that originally gave rise to the proposed registration requirement.<sup>3</sup> A “one size fits all” examination approach is simply not necessary in an industry that has a proven track record for developing training that is specific to the particular job responsibilities of an individual. Member firms know exactly what regulatory responsibilities have been assigned to specific personnel and are in the best position to tailor training to those specific responsibilities.<sup>4</sup>

## **II. The Scope of Persons Subject to the Registration Requirements Should Be Clarified and Limited.**

We believe that there are opportunities to refine and clarify the scope of persons subject to the registration requirement. The Proposal would require member firms to identify three categories of persons: (i) senior management; (ii) supervisors, managers or other persons responsible for approving or authorizing work; and (iii) persons with authority or discretion to commit the firm’s capital or to commit the firm to any contract or agreement with respect to the covered functions.

---

<sup>3</sup> Indeed, we believe that FINRA could eliminate the entire testing requirement and instead rely on Rule 1120 obligations to provide continuing firm element education to deliver the required content. Such an approach could be implemented more quickly than a traditional exam. In the event FINRA determined that this approach was inadequate, it could later develop and impose an examination requirement.

<sup>4</sup> If FINRA does determine to adopt a test requirement, we believe FINRA should publish the proposed study outline of the exam for notice and comment prior to making the test effective. Our concern in this regard is the sheer difficulty of writing an exam that effectively tests for the common areas of “essential knowledge” for a collective group of persons whose individual job functions are as broad as the enumerated covered functions. Even putting aside some of the more peripheral operations functions, such as securities valuations and IT/business security requirements, the core job elements for someone functioning in such a conventional operations function as a person who has been trained to confirm the names and addresses of customers (or to supervise that function) may differ substantially from the basic job functions of an individual who is responsible for maintaining a member firm’s stock loan records (or supervising the stock loan desk). It will be extremely difficult to develop, if indeed it is possible to devise, a test to cover regulatory requirements applicable to the universe of back-office jobs. This is why we urge FINRA to confine the exam to the first content theme (noted above) and take a broader, higher level ethics-based approach in developing the content of the examination.

Operations Professionals in each of these three categories would be subject to the registration, testing, and continuing education requirements of the proposed rule. We support the concept of limiting the scope of the new regulatory requirements to supervisory personnel rather than the inclusion, at this juncture, of “rank and file” operations personnel. We concur in the premise behind the proposal that limiting its scope to supervisory personnel will be sufficient in meeting the objective of sensitizing back office functions to important ethical considerations. Having said that, we find the scope of the subject supervisory personnel set out in the Proposal to be unduly expansive. Accordingly, we believe that the proposed categories need to be clarified and refined.<sup>5</sup>

### *Senior Management*

The first category would subject “senior management with responsibility over the covered functions” to the registration requirements. The proposed rule, however, does not define the upper or lower bounds of what constitutes “senior” management, particularly with respect to managers in roles senior to those in the second category pertaining to supervisors and other managers. Senior management at these levels are typically already licensed as Series 24 principals. We believe that registered principals, who are otherwise subject to registration and continuing education requirements, already satisfy FINRA's stated goal of enhancing the regulatory structure surrounding a member firm’s back-office operations. Indeed, no one has suggested (nor does the FINRA Notice explain) that senior management do not already receive adequate training commensurate with their responsibilities. We submit, accordingly, that requiring registered principals to become registered as Operations Professionals is unnecessary and therefore recommend that such individuals be completely exempt from the requirements of the proposed rule.<sup>6</sup>

### *Supervisors, Managers, and Other Persons*

The second category would subject to the registration requirements "supervisors, managers or other persons responsible for approving or authorizing work in direct furtherance of the covered functions, including work of other persons in the covered functions." The Notice goes on to state that persons whose responsibilities are below this level (or the level specified in the other two

---

<sup>5</sup> Indeed, the obligations associated with falling into one of the categories may extend well beyond the examination and continuing education requirements of becoming a registered Operations Professional. We note that it is unclear what the impact of the new rule will be as it relates to various state registration requirements. It could well be that states will require Operations Professionals to be registered - a requirement that would presumably extend to every state in which the firm has customers or conducts business. In addition to the additional costs associated with state registration fees, such a registration requirement presumably would trigger a requirement for Operations Professionals to take and pass the Series 63 examination, yet an additional requirement. Indeed, it is possible that some states (who do not recognize limited examinations) may require Operations Professionals to take and pass the Series 7 examination. For these reasons, it is critical that FINRA be as clear as possible in defining the categories of persons (and covered functions discussed later) subject to the registration requirement.

<sup>6</sup> We understand that the Proposal contains an exception to the qualification examination requirement for persons who hold certain principal-level registrations. For the reasons stated above, we are recommending that those registered principals be completely exempt from the Operations Professional registration requirement.

categories of covered persons), or are ancillary to or supportive of a covered function, are not subject to the registration requirement.

This category covers the core group of Operations Professionals toward which the new examination requirement is directed. We have several concerns with respect to its implementation, however. First, while more targeted than the first and third categories, we are concerned about the breadth of this category. As previously discussed, many back-office operations functions are segmented into very narrow work-skill sets, *i.e.*, one person has authority to perform a specific task (such as authorizing the addition of new marketing language to the firm's account statements), another person has authority to select the vendor (that produces the account statement), another person has authority to issue a corrected account statement, and a fourth person has overall responsibility for the content of account statements. On its face, the Proposal would appear to require that managers/supervisors of all four of these persons take the exam. We question the logic or benefits of such a result. Does the person with authority to select the vendor really pose a risk of customer harm? Doesn't the fact that any person with authority to select the vendor will ultimately report to a licensed representative or principal effectively address any risk? In our view, the universe of persons who may pose a risk to customers is narrower than the universe that would be covered under the Proposal. By forcing so many persons to register as Operations Professionals without a more selective analysis of a firm's operations and licensing structure, FINRA may create the false impression that the industry is better regulated without that being objectively true.

Second, there is a good deal of subjectivity involved in determining the personnel at a firm who fall into this category (as well as the first and to some extent the third categories). Determining who is responsible for approving or authorizing work in direct furtherance of a covered function, as opposed to having an ancillary or advisory role, inevitably involves judgment calls. For example, a person who manages the client on-boarding processes appears to be a covered person. However, there are roles ancillary to this which could as a literal matter be in scope, but might not necessarily be in scope under the spirit of the proposal. Such roles may include persons who determine new account qualification standards, design account opening forms or account statements, implement procedures for paper and/or electronic delivery of statements, determine the content and formatting of confirmation and account statement riders and other disclosures, or are involved with the physical creation and mailing of account statements. We urge FINRA to take measures to alleviate this potential confusion and subjectivity by providing greater clarity as to persons covered by the proposed rule.

We also believe there should be more clarity pertaining to whether supervisory personnel "up the chain of command" between the covered function and senior management are subject to the registration requirement. As one becomes more senior, the nexus between a senior manager and a covered function could become more distant. Reading the proposed requirement literally, while such intermediate supervisors may not be directly involved in the covered functions, their jobs would likely entail approving or authorizing work of some subordinates that directly relates to the covered functions. This result is exacerbated as one moves up the supervisory chain. As compliance professionals, we are concerned about the ability of our firms to manage the compliance risks associated with new rules. Unless the scope of coverage of the rule is

unambiguous, a firm is likely to construe its obligations broadly to include personnel not intended to be covered by the proposed rule, resulting in unnecessary cost and expense.<sup>7</sup>

Third, we are concerned about the mechanics of potential application of the rule to personnel employed by parents or affiliates of FINRA member firms, and conceivably to third-party outsourced service providers as well. We are particularly worried about how supervisory obligations with respect to such persons would be construed. The Notice states that “those persons subject to the new Operations Professional registration category would be considered associated persons of a firm *irrespective of their employing entity* and would be subject to all FINRA rules applicable to associated persons and/or registered persons” (emphasis added). Many FINRA member firms are part of larger financial services companies – banks, insurance companies, fund complexes or money managers. Most, if not all, FINRA member firms outsource some aspect of the covered functions to external vendors, which in turn have their own managers who oversee the provision of services to the FINRA member firm. The application of the proposed rule to personnel at these affiliated financial services companies and external service providers is deeply disturbing, particularly given FINRA’s stated view that, once subject to registration as Operations Professionals, these individuals would become associated persons for purposes of all FINRA rules.<sup>8</sup>

We believe there is a real possibility of confusion concerning a firm’s obligations with respect to vendors or outsourced service providers. To the extent that a FINRA member seeks to outsource functions to third parties, whether affiliates or unrelated vendors, we recognize that, under existing FINRA rules, it remains accountable for the oversight and supervision (*i.e.*, the management) of that activity through its own personnel. Since the purpose of the three categories is to identify operations personnel with supervisory responsibilities, we question why, at least as an initial matter, it is necessary to extend the application of the Operations Professional requirements beyond a FINRA member’s own personnel.

The consequences of the alternative suggested by the Notice are potentially profound. Once affiliated or third-party vendor personnel are registered as Operations Professionals, the Notice implies that they would become subject to the entire array of FINRA rules related to associated persons. In this regard, their personal securities accounts, as well as those of their immediate families, would conceivably be subject to the full array of member firm oversight obligations under FINRA rules, such as review of electronic communications or approval of outside

---

<sup>7</sup> In other contexts, such as the NYSE Compliance Principals Examination, very objective criteria have been established: the Series 14 examination is required to be taken by a firm’s Director of Compliance, and any subordinate compliance manager with supervisory responsibility over 10 or more persons. We urge FINRA, especially as an initial matter, to consider such an objective, more readily administrable approach.

<sup>8</sup> We appreciate the theoretical regulatory avoidance concern that has presumably prompted this part of the Proposal; *i.e.*, that a consolidated financial services firm might seek to reorganize its support functions so that operational personnel will not be subject to this examination requirement. We question, however, whether it is realistic to expect that a firm would pursue a corporate reorganization solely for this reason.

interests. This could lead to considerable confusion. For a FINRA member firm that is part of a consolidated financial services firm, the rule as proposed arguably imposes registration requirements on “senior management” (the first category above) or others from the parent firm who have authority to approve covered functions (the second category). These categories could easily include (indeed, arguably must include) parent company managers to whom the principal executive officer of the FINRA member firm reports, creating the ironic situation in which the principal executive officer of the FINRA member firm has the responsibility to supervise his or her supervisor within the parent organization. For third-party vendors, this requirement would create the unmanageable situation in which managers at the third-party vendor could be subject to “supervision” by managers at each of several FINRA member firms for whom the vendor provides services.

The managerial and compliance burdens outlined above are unnecessary. FINRA has provided guidance to member firms with respect to outsourcing arrangements, whether affiliate or third-party, that makes it clear that member firms do not absolve themselves of the responsibility for outsourced functions; they have an obligation both to conduct an initial due diligence analysis before outsourcing functions to third parties, and on a continuing basis to oversee, supervise and monitor the third party’s performance of outsourced activities (*see* NASD Notice to Members 05-48, July 22, 2005). Given the obligation imposed by that notice for a member firm to assure that “an appropriately qualified person monitors the [outsourcing] arrangement,” we believe it should be sufficient, at least as an initial matter, for FINRA to confine application of the proposed Operations Professional registration and examination requirements to employees of the member firm.

#### *Persons with Authority to Commit Capital or to Enter into Contracts or Agreements*

We find the third category potentially confusing in its scope. If (as we believe) it is intended to cover persons associated with a firm's prime brokerage operations, then it would appear to be redundant of the first two categories and therefore should be deleted, or re-stated to specifically limit its scope to prime brokerage.

Especially for FINRA member firms that are part of larger financial services organizations, the third category, if read literally, potentially could have broad application inside and outside the member firm, as the number of persons who have the ability or discretion to commit the firm’s capital or to enter into or approve contracts or agreements could be substantial and far-reaching within the organization leading to the same concerns articulated above with respect to the second category. The Proposal does suggest that it applies to capital commitments or contracts in “direct furtherance” of the covered functions. If this language is intended to limit the application of the requirement solely to those supervisors who are on the “front line” directly managing the covered functions, and not to supervisors senior to them, FINRA needs to make that clear. If this is the case, however, we question whether anyone is captured by this third category who is not already covered in by the second category.

### **III. Many of the Covered Functions Appear Overbroad and Should be Refined**

The Proposal identifies thirteen (13) different categories of “covered functions,” the managers of which would be subject to the proposed rule. Certain of those categories identify reasonably

concise functions. Others, however, raise issues of breadth of scope and lack of clarity as were discussed above with respect to the categories of covered persons. As previously stated, it is not unlikely that, to err on the side of caution, FINRA member firms will broadly interpret the categories of covered functions to include activities not intended to be covered by the Proposal, resulting in unnecessary cost and expense. We urge FINRA to provide clarity with respect to the categories of covered functions to avoid this result.

In several instances, the covered functions are quite broad, particularly for large institutions. For example, supervision over, or approval of contracts, agreements or the commitment of capital with respect to "trade confirmation, account statements, settlement, margin" and "client on-boarding (customer account data and document maintenance)" can cover a broad array of activities. These responsibilities could involve matters that potentially could "harm" investors or more generally relate to the protection of investors and the public interest, such as the establishment of policies governing the content of confirms, statements, account agreements and the like, developing and implementing qualification requirements for on-boarding of new customers, and imposing and administering customer financing (margin) requirements, buying-in customers, and the like. On the other hand, supervising and handling contracts for these covered functions could also cover purely mundane functions, such as ordering print stock for confirms and statements, managing a firm's mailroom and similar matters. While we appreciate the challenges confronting FINRA in devising language that clearly delineates between substantive supervision of activities that materially impact investor protection and responsibilities that are more mechanical, administrative or technical in nature, we urge FINRA to incorporate such a distinction into its description of the covered functions.

Second, several of the covered functions (in particular those identified in paragraphs (vi), (vii), (viii) and (xv) ) are not separate covered functions; rather, in each case, they describe activities undertaken with respect to other covered functions. They include capturing business requirements for systems related to covered functions (paragraph (vi)); setting business security and IT requirements for covered functions (paragraph (vii)); defining information entitlement policies (paragraph (viii)); and posting entries to the firm's books and records (paragraph (xv)). In each case, we question the benefits of imposing registration, examination and continuing education requirements on persons supervising these activities in addition to the managers that supervise the actual covered functions to which these ancillary activities relate. We believe our member firms will be adequately managed, and public investors adequately protected, if the front-line supervisors to whom these support roles provide services are sufficiently sensitized. Inclusion of these ancillary roles within the scope of the proposed rule introduces significant additional ambiguity, and heightens the risk that the rule's scope will be extended to personnel at affiliates or service providers who are involved in activities far afield from the substantive areas tested by the examination. For example, the personnel responsible for establishing information entitlement policies for large banking, insurance and money management organizations are frequently employed at the enterprise level, not (just) at the broker-dealer level. They have to concern themselves with information security and privacy laws, rules and policies beyond those applicable to the FINRA member firm. So long as the member firm personnel who supervise the covered functions are appropriately sensitized, we see substantial incremental burdens, and virtually no benefits, from imposing the proposed rule's requirements on these potentially far-flung roles.

In any event, should FINRA choose to retain one or more of these categories, as a matter of drafting clarity the listing of the covered functions in paragraph (b)(6)(B) should be reorganized. We suggest that FINRA group these dependent covered functions into a single entry at the end of paragraph (b)(6)(B), which would note that these covered functions relate to the previously enumerated functions (*e.g.*, "with respect to the above covered functions: (1) capturing of business requirements for sales, trading and other systems, (2) defining and approving business security requirements, (3) defining information entitlement policy, and (4) posting entries to the member's books and records"). As currently drafted, if applied literally, the proposed rule would deem a covered function to include the posting of entries to the member's books and records relating to the Firm's information entitlement policy, or the capturing of the business requirements for setting up the information entitlement policy. We question whether this sweeping scope of coverage was intended.

### **Effective Date**

The Proposal states that the test would be phased in within a six-to-nine month period following the effective date of the rule. We urge FINRA to adopt a longer phase in period, *e.g.*, twelve months, in recognition of the efforts member firms will need to undertake as organizations, and individual persons will need to prepare for the test. We believe that when FINRA implemented other new exams (*e.g.*, for investment banking and research analysts), effected persons were given a twelve month period in which to prepare. We further urge FINRA to allow newly hired employees a phase-in time in which to pass the examination during which they will be permitted to perform their respective covered functions.

\* \* \*

NSCP appreciates the opportunity to provide comments on the Proposal and hopes you find these comments useful. NSCP would be pleased to assist FINRA in any way that it can going forward with this initiative. Please feel free to contact the undersigned should you have any questions or require further information regarding our comments.

Sincerely,



Joan Hinchman  
Executive Director, CEO and President  
NSCP