# Notices

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# Regulatory Notice

### 11-50

### **Discovery**

SEC Approves Amendments to FINRA Rule 9251 to Explicitly Protect From Discovery Those Documents That Federal Law Prohibits FINRA From Disclosing

Effective Date: December 2, 2011

### **Executive Summary**

The SEC recently approved an amendment to FINRA Rule 9251 (Inspection and Copying of Documents in Possession of Staff) that explicitly protects from discovery during FINRA proceedings those documents that federal law prohibits FINRA from disclosing. The amended rule text is set forth in Attachment A and is effective December 2, 2011.

Questions concerning this *Notice* should be directed to:

- ▶ James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270; or
- Matthew E. Vitek, Counsel, OGC, at (202) 728-8156.

### Background & Discussion

FINRA Rule 9251 describes the types of documents that FINRA's Enforcement and Market Regulation Departments must produce to respondents during the discovery phase of a FINRA proceeding. The rule also explicitly protects certain types of documents from production. Enforcement and Market Regulation, for example, may withhold documents that are protected by attorney-client privilege or work-product immunity.<sup>2</sup> The rule, however, previously did not explicitly protect from discovery documents that federal law prohibits FINRA from disclosing. Enforcement and Market Regulation had to seek a hearing officer "good cause" determination allowing them to withhold such documents.<sup>3</sup> The SEC recently approved an amendment to Rule 9251 that increases efficiency by avoiding the need for the parties to brief and hearing officers to resolve "good cause" motions regarding documents that FINRA cannot legally produce.

### November 2011

### **Notice Type**

► Rule Amendment

### Suggested Routing

- ► Compliance
- ► Legal
- ► Senior Management

### **Key Topics**

- ► Code of Procedure
- **▶** Discovery

#### Referenced Rules & Notices

► FINRA Rule 9251



Amended Rule 9251 now explicitly allows Enforcement and Market Regulation automatically to withhold from discovery documents that federal law prohibits them from disclosing. The amended rule also prohibits a hearing officer from ordering Enforcement or Market Regulation to either produce or reveal information about the existence of a document to a respondent if federal law prohibits such disclosure. The amendment, however, contains a procedural safeguard allowing a hearing officer to review a document to determine whether federal law prohibits Enforcement or Market Regulation from disclosing it.

### **Endnotes**

- See Exchange Act Release No. 65281 (September 7, 2011), 76 FR 56848 (September 14, 2011) (Order Approving Proposed Rule Change; File No. SR-FINRA-2011-031).
- 2. FINRA Rule 9251(b)(1)(A).
- 3. FINRA Rule 9251(b)(1)(D).

- See FINRA Rule 9251(b)(2); see also Exchange Act Release No. 65281 (September 7, 2011), 76 FR 56848 (September 14, 2011) (Order Approving Proposed Rule Change; File No. SR-FINRA-2011-031).
- 5. FINRA Rule 9251(c).
- 6. *Id*.

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### **ATTACHMENT A**

#### **Text of Amended Rule**

New language is underlined; deletions are in brackets.

\*\*\*\*

### 9200. DISCIPLINARY PROCEEDINGS

\* \* \* \* \*

9250. Discovery

### 9251. Inspection and Copying of Documents in Possession of Staff

- (a) No Change.
- (b) Withheld Documents [That May Be Withheld]
  - (1) No Change.
- (2) <u>The Department of Enforcement or the Department of Market Regulation shall</u> withhold a Document if the Document is prohibited from disclosure by federal law.
- (3) Nothing in paragraph (b)(1) authorizes the Department of Enforcement or the Department of Market Regulation to withhold a Document, or a part thereof, that contains material exculpatory evidence.
- (c) Withheld Document List

The Hearing Officer may require the Department of Enforcement or the Department of Market Regulation to submit to the Hearing Officer a list of Documents withheld pursuant to paragraph[s] (b)[(1)(A) through (D)] or to submit to the Hearing Officer any Document withheld. Upon review, the Hearing Officer may order the Department of Enforcement or the Department of Market Regulation to make the list or any Document withheld available to the other Parties for inspection and copying <u>unless federal law prohibits disclosure of the Document or its existence</u>. A motion to require the Department of Enforcement or the Department of Market Regulation to produce a list of Documents withheld pursuant to paragraph (b) shall be based upon some reason to believe that a Document is being withheld in violation of the Code.

(d) through (g) No Change.

\* \* \* \* \*

# Regulatory Notice

# 11-51

### BD and IA Renewals for 2012

Broker-Dealer, Investment Adviser Firm, Agent and Investment Adviser Representative, and Branch Renewals for 2012

Payment Deadline: December 12, 2011

### **Executive Summary**

The 2012 Renewal Program begins on November 14, 2011, when FINRA makes the online Preliminary Renewal Statements available to all firms on Web CRD/IARD.

Firms should note the following key dates in the renewal process:

October 24, 2011 Firms may begin submitting post-dated Form U5 and BR Closing/Withdrawal filings via Web CRD/IARD.

**November 1, 2011** Firms may begin submitting post-dated Form BDW and ADV-W filings via Web CRD/IARD.

**Please Note:** Post-dated filings submitted by 11 p.m., Eastern Time (ET), November 11, 2011, do not appear on the firm's Preliminary Renewal Statement. The only allowed date for post-dated termination filings is

December 31, 2011.

**November 14, 2011** Preliminary Renewal Statements are available on Web CRD/IARD.

**December 12, 2011** Full payment of Preliminary Renewal Statements is due.

January 3, 2012 Final Renewal Statements are available on Web CRD/

**February 3, 2012** Full payment of Final Renewal Statements is due.

### November 2011

### Notice Type

► Renewals

### **Suggested Routing**

- ► Compliance
- ► Legal
- ▶ Operations
- ► Registration
- ► Senior Management

### **Key Topics**

- ► Web CRD®
- ► IARD™
- ► Registration
- ► Renewals

### Referenced Rules & Notices

► NTM 02-48



FINRA advises FINRA-registered firms that failure to remit full payment of their Preliminary Renewal Statements to FINRA by December 12, 2011, may cause the firm to become ineligible to do business in the jurisdictions where it is registered, effective January 1, 2012. FINRA-registered firms will also be subject to a late fee if payment is not received by this deadline.

In addition to this *Notice*, firms should review the <u>renewal instructions</u>, especially the *2012 Renewal Program Bulletin*, the *2012 IARD Renewal Program Bulletin* (if applicable) on the <u>Investment Adviser Registration Depository</u> (IARD) website, and any information mailed to ensure continued eligibility to do business as of January 1, 2012.

Please direct questions concerning this *Notice* to the FINRA Gateway Call Center at (301) 869-6699.

### **Background & Discussion**

### **Preliminary Renewal Statements**

Beginning November 14, 2011, Preliminary Renewal Statements are available for viewing and printing on Web CRD/IARD. The statements include the following fees:

- Web CRD system processing fees;
- ► FINRA branch office fees:
- FINRA branch renewal processing fees;
- ▶ American Stock Exchange (AMEX), BATS Y-Exchange, Inc. (BATS-YX), BATS Z-Exchange, Inc. (BATS-ZX), NASDAQ OMX BX, Inc. (BX), C2 Options Exchange, Incorporated (C2), Chicago Board Options Exchange (CBOE), Chicago Stock Exchange (CHX), EDGA Exchange, Inc. (EDGA), EDGX Exchange, Inc.(EDGX), International Securities Exchange (ISE), NASDAQ Stock Exchange (NQX), New York Stock Exchange (NYSE), NYSE Arca, Inc. (ARCA), and NASDAQ OMX PHLX, Inc. (PHLX) maintenance fees;
- state agent renewal fees;
- state BD renewal fees:
- state BD branch fees;
- investment adviser firm and representative renewal fees, if applicable; and
- broker-dealer and/or investment adviser branch renewal fees.

FINRA must receive full payment of the Preliminary Renewal Statement fees no later than December 12, 2011.

If payment is not received by December 12, 2011, FINRA-registered firms will be assessed a Renewal Payment Late Fee. FINRA includes this late fee as part of the Final Renewal Statement and calculates the fee as follows: 10 percent of a member firm's cumulative final renewal assessment or \$100, whichever is greater, with a cap of \$5,000. Please see Notice to Members (NTM) 02-48 for details. In addition, if FINRA fails to receive payment by the deadline, firms also risk becoming ineligible to do business in the jurisdictions where their registrations are not renewed.

#### **Fees**

FINRA assesses a fee of \$30 for each registered representative who renews his/her registration with any regulator through Web CRD. Firms can access a listing of agents assessed this fee by requesting the Renewals—Firm Renewal Roster.

In addition, any investment adviser fees assessed by the North American Securities Administrators Association (NASAA) for state-registered investment adviser firms and investment adviser representatives (RA) who renew through IARD will also be included on the Preliminary Renewal Statement.

Based on the number of active FINRA branches, FINRA assesses each firm a branch office assessment fee of \$75 per branch. FINRA waives one branch office assessment fee per firm.

Based on the number of active FINRA branches, FINRA assesses each firm a FINRA branch renewal processing fee of \$20 per branch. FINRA waives one branch renewal processing fee per firm.

**Please Note:** FINRA does not assess the personnel assessment fees through the annual Renewal Program. FINRA will mail all FINRA-registered firms a separate invoice for these fees. Firms can obtain a listing of agents for whom the firms will be assessed the personnel assessment fee by requesting the Renewals—Firm Renewal Roster.

Web CRD/IARD assesses renewal fees for AMEX, ARCA, BATS-YX, BATS-ZX, BX, C2, CBOE, CHX, EDGA, EDGX, ISE, NQX, NYSE, PHLX and state registrations on the Preliminary Renewal Statement. The system displays any applicable fees for the number of individuals registered in each SRO and jurisdiction.

Web CRD/IARD assesses branch office renewal fees for those regulators that choose to renew branches registered with them in Web CRD/IARD.

Some participating jurisdictions may require steps beyond the payment to FINRA of renewal fees to complete the broker-dealer or investment adviser renewal process. Firms should contact each jurisdiction directly for further information on state renewal requirements. A Regulator Directory is located on the NASAA website.

For detailed information regarding 2012 investment adviser renewals, you may also visit the <u>IARD website</u>. A matrix of investment adviser <u>renewal fees</u> for states that participate in the 2012 IARD Renewal Program is also posted on the IARD website.

### **Renewal Payment**

Firms are encouraged to check their Renewal Statements to confirm payment has been received by FINRA and that the firm's Renewal Statement balance is paid in full. Firms have four payment methods available to pay renewal fees:

- 1. Automatic Daily Account-to-Renewal Account Transfer
- 2. Web CRD/IARD E-Pay
- 3. Check
- 4. Wire Transfer

### **Automatic Daily Account-to-Renewal Account Transfer**

FINRA will automatically transfer funds from a firm's Daily Account to its Renewal Account to facilitate payment of renewal fees on December 12, 2011, the Preliminary Renewal Statement payment deadline. FINRA will transfer funds only if a firm has sufficient funds available in its Daily Account on December 12 to cover the amount due. **Please Note:** If a firm does not want funds automatically transferred, the firm should ensure FINRA receives payment in its Renewal Account by the deadline. Separately, if a firm wishes to transfer funds between affiliated firms, the firm should submit a <u>Web CRD/IARD Account Transfer</u> Form available on the FINRA website.

### Web CRD/IARD E-Pay

The Web CRD/IARD E-Pay application is accessible from both the Preliminary and Final Renewal Statements and the FINRA (<a href="www.finra.org/crd">www.finra.org/crd</a>) or IARD (<a href="www.iard.com">www.iard.com</a>) websites. This application allows a firm to make an electronic payment from a designated bank account to the firm's Renewal Account with FINRA. Please note that in order for funds to post to your firm's Renewal Account by December 12, 2011, you must submit payment electronically no later than 8 p.m., ET, on December 8, 2011.

### Check

The check must be drawn on the FINRA-registered firm's account and include the firm's CRD number and "Renewal" in the memo line. Firms paying by check should account for U.S. mail delivery and payment processing time. To ensure prompt processing of your renewal payment check:

- Include a print-out of the first page of your Preliminary Renewal Statement with payment.
- **Do not** include any other forms or fee submissions.
- Make the check payable to FINRA and write your firm's CRD number and "Renewal" on the check memo line.
- Send payment in the blue, pre-addressed renewal payment envelope mailed to your firm in early November or write the address on an envelope exactly as noted in this *Notice*:

U.S. Mail	Overnight or Express Delivery

FINRA FINRA

P.O. Box 7777-W8705 Attention: 8705

Philadelphia, PA 19175-8705 500 Ross Street 154-0455 Pittsburgh, PA 15262

(Note: This box will not accept courier

or overnight deliveries.) Telephone: (301) 869-6699

**Please Note:** The addresses for renewal payments are different from the addresses for funding firms' Web CRD/IARD Daily Accounts.

### **Wire Payment**

Firms may wire full payment of their Preliminary Renewal Statements by requesting their banks to initiate wire transfers to: "Mellon Financial, Philadelphia, PA." Firms should provide their banks with the following information:

Transfer funds to: Mellon Financial, Philadelphia, PA

ABA Number: 031 000 037
Beneficiary: FINRA
FINRA Account Number: 8-234-353

Reference Number: Firm CRD number and "Renewal"

To ensure prompt processing of a renewal payment by wire transfer, remember to:

- Inform the bank to credit funds to the FINRA bank account.
- ▶ Provide the firm's CRD number and "Renewal" as reference only.
- Record the confirmation number of the wire transfer provided by the bank.

### **Renewal Reports**

Beginning November 14, 2011, member firms can request, print and/or download renewal reports via Web CRD/IARD. Three reports are available for reconciliation with the Preliminary Renewal Statement:

- Firm Renewal Report This report lists individuals included in the Renewal Program and includes billing codes (if they have been supplied by the firm).
- ▶ Branches Renewal Report This report lists each branch registered with FINRA and/or with any other regulator that renews branches registered with the regulator through Web CRD/IARD and for which the firm is being assessed a fee. Firms should use this report to reconcile their records for renewal purposes.
- ▶ Approved AG Reg Without FINRA Approval Report This report contains all individuals who are not registered with FINRA, but are registered with one or more jurisdictions. Firms should request this report as soon as possible to determine if it needs to request any FINRA registrations or terminate jurisdiction registrations.

### **Post-Dated Form Filings**

Firms can file termination forms with a termination date of December 31, 2011. If a Form U5, BDW, BR Closing/Withdrawal or ADV-W filing indicates a termination date of December 31, 2011, an agent (AG), investment adviser representative, broker-dealer and/or investment adviser (firm) and the branch may continue doing business in that jurisdiction until the end of the calendar year without being assessed renewal fees. **December 31, 2011, is the only date allowed for a post-dated form filing.** 

Firms can begin filing post-dated Form U5 and BR Closing/Withdrawal filings via Web CRD/IARD on October 24, 2011. In addition, firms can begin filing post-dated Form BDW and ADV-W filings via Web CRD/IARD on November 1, 2011. Firms that submit post-dated termination filings by 11 p.m., ET, on November 11, 2011, **will not** be assessed renewal fees for the terminated registrations on their Preliminary Renewal Statements. Firms that submit post-dated termination filings on, or after, November 14, 2011, will not be assessed renewal fees for the terminated jurisdictions on their Final Renewal Statements in January 2012. Those firms should see a credit balance on their Final Renewal Statements if the firm has not requested additional registrations during that time period to offset the credit balance.

After submitting any termination filing, firms should query individual, branch and/or firm registrations to ensure that Form U5, BDW, BR Closing/Withdrawal and ADV-W filings process by the renewal filing deadline date of 6 p.m., ET, on December 23, 2011.

Firms should exercise care when submitting all post-dated filings. Web CRD/IARD processes these forms as firms submit them and FINRA cannot withdraw a post-dated termination filing once it is submitted. A firm that submits a post-dated termination filing in error will have to file a new Form U4, BD, Form BR or Form ADV when Web CRD/IARD resumes normal processing on January 3, 2012, and Web CRD/IARD will assess new registration fees.

### **Filing Form BDW**

The CRD Phase II Program allows firms requesting broker-dealer termination (either full or partial) to file their Forms BDW via Web CRD. Firms that file either a full or partial Form BDW by 11 p.m., ET, November 11, 2011, avoid the assessment of the applicable renewal fees on their Preliminary Renewal Statements, provided that the regulator is a CRD Phase II participant. Currently, only five regulators participate in Web CRD renewals for agent fees, but **do not** participate in CRD Phase II:

- American Stock Exchange
- Chicago Stock Exchange
- National Stock Exchange
- NYSE Arca, Inc.
- ► NASDAQ OMX PHLX, Inc.

Firms requesting termination with any of those five regulators must submit a paper Form BDW directly to that regulator, as well as submit one electronically via Web CRD.

The deadline for electronic filing of a Form BDW for any firm that wants to terminate a registration before year-end is 6 p.m., ET, December 23, 2011. This same date applies to the filing of any Form BDW with regulators that are not Phase II participants.

# Filing Forms ADV to Cancel Notice Filings or Forms ADV-W to Terminate Registrations

Firms that file either a Form ADV Amendment, unmarking a state (generating the status of "Removal Requested at End of Year") or a Form ADV-W by 11 p.m., ET, November 11, 2011, avoid the assessment of applicable renewal fees on their Preliminary Renewal Statements. The deadline to file Form ADV Amendments or Form ADV-W for firms that want to cancel a notice filing or terminate a state registration before year-end is 6 p.m., ET, December 23, 2011.

### **Removing Open Registrations**

Throughout the year, firms have access to the "Approved AG Reg Without FINRA Approval Report" via Web CRD. This report identifies agents with an approved jurisdiction registration but who do not have an approved FINRA registration. Member firms should use this report to terminate obsolete jurisdiction registrations through the submission of a Form U5 or reinstate the FINRA positions through the filing of a Form U4 Amendment. Firms should request this report as soon as possible so they can identify individuals to terminate by November 11, 2011, to avoid renewal charges for those individuals on their Preliminary Renewal Statements. This report also advises the firm if there are no agents at the firm within this category.

#### **Final Renewal Statements**

On January 3, 2012, FINRA makes available all Final Renewal Statements on Web CRD/IARD. These statements reflect the status of broker-dealer, registered representative (AG), investment adviser firm and investment adviser representative (RA) registrations and/or notice filings as of December 31, 2011. Any adjustments in fees owed resulting from registration terminations, approvals, notice filings or transitions after the Preliminary Renewal Statement appear on the Final Renewal Statement in Web CRD/IARD.

- Web CRD/IARD reflects an amount owed if a firm has more individuals, branch offices or jurisdictions registered and/or notice filed on Web CRD/IARD at year-end than it did when the Preliminary Renewal Statement was generated.
- ▶ Web CRD/IARD issues a refund if a firm has fewer individuals, branch offices or jurisdictions registered or notice filed at year-end than it did on the Preliminary Renewal Statement. Note that FINRA transfers overpayments to the firms' Daily Accounts on January 3, 2012. Firms that have a credit balance in their Daily Accounts may submit a written and signed refund request by mail to: FINRA, Finance Department, 9509 Key West Avenue, Rockville, MD 20850; or by fax to: (240) 386-5344. The request should include a print-out of the firm's credit balance as reflected on Web CRD/IARD.

On or after January 3, 2012, FINRA-registered firms and joint BD/IA firms should access the Web CRD reports functionality for the **Firm Renewal Report**, which will list all individuals renewed with FINRA, AMEX, ARCA, BATS-YX, BATS-ZX, BX, C2, CBOE, CHX, EDGA, EDGX, ISE, NQX, NYSE, PHLX and each jurisdiction. Agents and RAs whose registrations are "approved" in any of these jurisdictions during November and December will be included in this roster. "Pending" and "deficient" registrations at year's end are not included in the Renewal Program. Firms will also be able to request the **Branches Renewal Report** that lists all branches for which they have been assessed renewal fees. Versions of these reports will also be available for download.

Firms have until **February 3, 2012**, to report any discrepancies on the renewal reports. This is also the **deadline for receipt of final payment**. Specific information and instructions concerning the Final Renewal Statement and renewal reports will be available in a January 2012 *Regulatory Notice*.

# Regulatory Notice

# 11-52

### **Senior Designations**

### FINRA Reminds Firms of Their Obligations Regarding the Supervision of Registered Persons Using Senior Designations

### **Executive Summary**

FINRA is publishing this *Notice* to remind firms of their supervisory obligations regarding the use of certifications and designations that imply expertise, certification, training or specialty in advising senior investors (senior designations). This *Notice* also outlines findings from a survey of firms and highlights sound practices used by firms with respect to senior designations. Firms are encouraged to adopt the practices that are outlined in this *Notice* to strengthen their own supervisory procedures, as appropriate to their business.

Questions or comments concerning this *Notice* may be directed to Lisa Stepuszek, Associate Director, Office of Risk, at (561) 443-8015.

### **Background and Discussion**

For several years, FINRA has focused on firms' fair dealings with senior investors, as well as investors at or approaching retirement (hereinafter together referred to as senior investors). In this regard, in September 2007, FINRA issued *Regulatory Notice 07-43*, which highlighted certain issues that are common to many senior investors and reminded firms of their obligations in this area. In 2008¹ and 2010², FINRA joined with other regulators to issue findings and guidance on firms' practices relative to senior investors. Most recently, in the 2011 Annual Regulatory and Examination Priorities <u>Letter</u>, FINRA reiterated that the protection of vulnerable customers, including senior investors, continues to be a high regulatory priority.

One area of particular focus is the use of certifications and designations that imply expertise, certification, training or specialty in advising senior investors.

### November 2011

### **Notice Type**

► Guidance

### Suggested Routing

- ► Advertising
- ► Compliance
- ► Continuing Education
- ► Legal
- ► Registered Representatives
- ► Senior Management

### **Key Topics**

- Communications With the Public
- ► Designations & Credentials
- ► Retirement
- ► Senior Investors
- Supervision

### Referenced Rules & Notices

- ► Regulatory Notice 07-43
- ► FINRA Rule 2010
- NASD Rule 2210
- NASD Rule 3010
- NYSE Rule 472



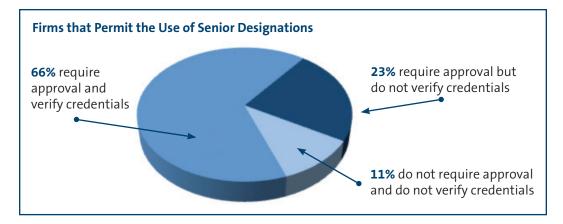
### 2011 Senior Designation Survey

To better understand the use and oversight of senior designations, in January 2011, FINRA surveyed retail broker-dealer firms that varied in terms of size, location, product mix and business model. One hundred fifty-seven firms provided responses to the survey, which focused on the prevalence of senior designation usage, the extent to which particular senior designations were used or prohibited and the supervisory systems in place regarding senior designations. Additional survey results are available at <a href="https://www.finra.org/industry/issues/seniors">www.finra.org/industry/issues/seniors</a>.

Survey responses point to widespread use of senior designations in the broker-dealer community. Specifically, 68 percent of firms that completed the survey indicated that they allow the use of senior designations by registered persons. Of the firms that permit the use of senior designations:

- ▶ 89 percent currently have registered persons who use senior designations; and
- ▶ 11 percent do not have any registered persons using senior designations at this time.

The following chart summarizes the survey responses of those firms that have registered persons who use senior designations.



Survey respondents that allow registered persons to use senior designations were asked whether they prohibit the use of any particular designations. While 73 percent of the responding firms reported that they prohibit the use of particular senior designations, 27 percent said that they do not have any such prohibitions. Of the firms that prohibit the use of particular designations, some banned the use of only one or two designations while other firms were much more restrictive—*i.e.*, allowing the use of only a small number of designations.

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Firms were also asked whether they require registered persons to obtain senior or other professional designations prior to marketing certain products to senior investors. Only two responding firms indicated that they require designations relative to interactions with senior investors.

When asked how the firms determined which designations could be used by registered persons, a majority of firms that completed the survey indicated that they review course work, other prerequisites and continuing education requirements prior to allowing or approving a designation. A smaller number of the responding firms indicated that they took a narrower approach by permitting only a select few designations. Other criteria used to determine whether a designation would be permitted included an assessment of state requirements that regulate the use of designations.

In certain instances, senior designations approved by firms or widely used by registered persons did not require rigorous qualification standards. As a result, the existence of qualification standards to obtain a designation did not ensure that those registered persons holding the designation possessed financial services skills that were unique or valuable to senior investors. This finding was consistent across survey participants and is of concern to FINRA. Investors are unlikely to differentiate between designations that represent an enhanced level of proficiency in dealing with financial matters relevant to senior investors versus a designation that is simply a marketing tool.

### **Sound Practices**

This *Notice* is not intended as a comprehensive summary of all compliance and supervisory matters pertaining to senior designations; rather, it discusses measures that may assist firms in complying with their supervisory obligations. FINRA encourages firms to consider the practices described below in assessing their own procedures and implementing improvements that will best protect their customers.

Most responding firms indicated that they have adopted and implemented policies governing the use of senior designations. Some firms simply ban the use of senior designations, while other firms establish standards necessary to obtain approval for their use. When standards and approvals are in place, most firms that completed the survey indicated that they monitor whether registered persons have met the criteria to use a particular senior designation.

NASD Rule 3010 requires each firm to establish and maintain a system to supervise the activities of each registered person that is reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules. As discussed in Regulatory Notice 07-43, firms, at a minimum, must have supervisory procedures in place reasonably designed to prevent their registered persons from using a senior designation in a manner that is unethical or misleading. Firms that allow the use of any title or designation that

conveys an expertise in senior investments or retirement planning where such expertise does not exist may violate FINRA Rule 2010, NASD Rule 2210, NYSE Rule 472, and possibly the anti-fraud provisions of the federal securities laws and FINRA rules.

NASD Rule 2210 and NYSE 472 prohibit firms and registered persons from making false, exaggerated, unwarranted or misleading statements or claims in communications with the public. This prohibition includes referencing nonexistent or self-conferred degrees or designations or referencing legitimate degrees or designations in a misleading manner. Firms therefore must have adequate supervisory procedures in place to ensure that their registered persons do not violate this requirement. As with all supervisory procedures, these procedures should be written, clearly communicated to employees, effectively enforced, and they should cover how approved designations may be used. In addition, FINRA reminds firms that all advertisements and sales literature as defined in NASD Rule 2210(a), including communications that include the use of these designations, must be approved prior to use and in writing by a registered principal pursuant to NASD Rule 2210(b)(1).

Firms may also want to consider adopting some of the practices and procedures described below, as appropriate based on their circumstances. For instance, firms may reduce the risk of confusion or overreliance by their customers by implementing procedures aimed at only permitting their registered persons to use senior designations that instill substantive knowledge to better serve and protect senior investors.

### **Designation Standards and Supervision**

Some firms indicated that they prohibit designations that do not have:

- a rigorous curriculum;
- an emphasis on ethics;
- continuing education requirements;
- a method for determining the registered person's status regarding the designation;
   and/or
- a public disciplinary process.

When deciding whether to use or approve designations, certain firms stated that registered persons who want to use a senior designation and represent themselves as experts in senior and retirement investing must remain current with continuing education or other requirements necessary to remain in good standing with the issuing organization. The firms also require registered persons to demonstrate a level of experience in retirement planning and other related matters, as well as the ability to work with senior investors.

In addition, many firms indicated that they take into consideration whether a designation is recognized by a reputable or accredited organization and whether the issuing organization has a code of ethics or a standard of professional conduct that must be followed.

### **Communications With the Public**

Many firms identified valuable practices focused on comprehensive reviews of advertising, sales literature, correspondence and emails to detect:

- registered persons who may be using a self-conferred or misleading designation without the knowledge of the firm; and/or
- designations being used that have not been earned or approved.

To detect and prevent these violative practices, some firms only allow registered persons to use business cards or letterhead stationery that is prepared centrally and approved by the firm. Other firms seek to curtail instances where senior investors could be most vulnerable by prohibiting the use of senior designations during sales seminars or "free lunches" with senior investors. Additionally, some firms use key word searches when reviewing correspondence and emails to monitor the use of designations. Certain responding firms also conduct unannounced audits of branch offices to ensure, among other things, that they are aware of all advertising, sales literature and correspondence being used with customers and that all materials are being used appropriately.

### **Training**

Certain firms represented that they require registered persons to attend training sessions focused on:

- retirement planning;
- ethics in working with senior investors; and/or
- the proper use of senior designations in advertising, sales literature and correspondence.

This type of training enables firms to convey information to registered persons regarding the special issues that relate to senior investors.

### **Annual Attestations**

In addition to requiring pre-approval to use senior designations, some firms required registered persons to periodically certify:

- the designations they use;
- that designations they use are not self-conferred;
- that they meet the continuing education requirements; and/or
- that they are in good standing with the organization that has conferred the designation.

While this information is self-reported by the registered person, it provides firms with an additional level of information to assist with monitoring and supervising the use of designations.

### Conclusion

The survey results indicate that while some firms ban senior designations outright, it is more common for firms to permit the use of senior designations pursuant to specified supervisory procedures. The majority of firms responding to the survey that allow the use of senior designations require, at a minimum, registered persons to obtain prior approval or to use only designations that have been pre-approved by the firm. Some firms also verify required credentials underlying designations.

While these results are positive, the survey indicated that some supervisory procedures were not particularly discerning regarding the quality of the designations that registered persons were permitted to use. In addition, some firms had no meaningful procedures for determining the prerequisites for obtaining designations used by their registered persons. FINRA encourages firms to consider implementing, as appropriate to their business, the sound practices outlined in this *Notice* to strengthen their own supervisory procedures.

### **Endnotes**

- http://www.sec.gov/spotlight/seniors/ seniorspracticesreport092208.pdf
- 2. <a href="http://www.sec.gov/spotlight/seniors/seniorspracticesreport081210.pdf">http://www.sec.gov/spotlight/seniors/seniors/seniorspracticesreport081210.pdf</a>

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# Regulatory Notice

# 11-53

# Trade Reporting and Compliance Engine (TRACE)

SEC Approves Amendments to TRACE Reporting Requirements to Conform With Requirements in the Multi Product Platform

Effective Date: February 6, 2012

### **Executive Summary**

The SEC approved amendments to FINRA Rule 6730 regarding member firms' reporting obligations when reporting transactions in TRACE-eligible securities other than asset-backed securities.¹ FINRA amended the reporting requirements in connection with the consolidation of all TRACE-eligible securities transaction processing and data management on a single technology platform, the multi product platform (MPP).

The amended rule text is available at www.finra.org/notices/11-53.

Questions regarding this Notice may be directed to:

- FINRA Operations at (866) 776-0800;
- Patrick Geraghty, Director, Market Regulation, at (240) 386-4973;
- ► Elliot R. Levine, Associate Vice President and Counsel, Transparency Services, at (202) 728-8405; or
- ▶ Office of General Counsel at (202) 728-8071.

### Background & Discussion

Currently, FINRA receives TRACE transaction reports for TRACE-eligible securities that are asset-backed securities and manages the TRACE data regarding those securities (e.g., the TRACE daily list) on FINRA's enhanced technology platform, MPP.<sup>2</sup> FINRA intends to migrate TRACE-eligible securities that are not currently on the MPP—corporate bonds and agency debt securities—to the MPP, and, in connection with the migration, has amended certain reporting requirements in FINRA Rule 6730 to conform to the requirements of the MPP.<sup>3</sup> The migration and the rule amendments will take effect on February 6, 2012.

### November 2011

### **Notice Type**

► Rule Amendment

### Suggested Routing

- ► Compliance
- ► Fixed Income
- ► Legal
- ▶ Operations
- Systems
- ▶ Trading
- Training

### **Key Topics**

- ► Multi Product Platform
- ► TRACE-Eligible Security
- ► Transaction Reporting

### Referenced Rules & Notices

- ► FINRA Rule 6710
- ► FINRA Rule 6730
- ► Regulatory Notice 11-20



The substantive amendments to FINRA Rule 6730, which apply to transactions other than transactions in asset-backed securities, are as follows:

- ► Transactions executed on a non-business day. FINRA Rules 6730(a)(1)(D) and 6730(a)(2) (B) are amended to permit a firm to report the actual date of execution when reporting a transaction that is executed on a Saturday, a Sunday, a holiday or any day that the TRACE system is not open.<sup>4</sup>
- ▶ **Size (volume).** FINRA Rules 6730(c)(2) and 6730(d)(2) are amended to require a firm to report the size (volume) of a transaction as the total par value or principal value traded, rather than as the number of bonds, as required under the legacy TRACE system.
- ► **Commission.** FINRA Rules 6730(c)(11) and 6730(d)(1) are amended to require a firm to report the total dollar amount of the commission, rather than the points per bond, as required under the legacy TRACE system.
- ➤ **Settlement.** A new provision in FINRA Rule 6730(c)(12) requires a firm to report the date of settlement. FINRA Rule 6730(d)(4)(B), requiring the use of settlement modifiers for certain settlements, is deleted, as are references to the settlement modifiers in FINRA Rule 6730(d)(4)(C).<sup>5</sup>

### **Endnotes**

- See Securities Exchange Act Release No. 65791 (November 18, 2011), 76 FR 72736 (November 25, 2011) (SEC Order Approving File No. SR-FINRA-2011-053).
- Asset-backed securities have been reported via MPP since reporting requirements went into effect. (See Securities Exchange Act Release No. 64364 (April 28, 2011), 76 FR 25385 (May 4, 2011) (SEC Order Approving File No. SR-FINRA-2011-012) and Regulatory Notice 11-20 (May 2011).) "TRACE-eligible security" and "asset-backed security" are defined in FINRA Rule 6710(a) and FINRA Rule 6710(m), respectively.
- "Agency debt security" is defined in FINRA Rule 6710(I).
- 4. The legacy TRACE system did not recognize such days as valid dates of execution.
  - The amendments also combine FINRA Rules 6730(a)(1)(B) and 6730(a)(1)(D) as renumbered amended FINRA Rule 6730(a)(1)(D), and delete current FINRA Rule 6730(a)(1)(B). In addition, the amendments reorder the reporting requirements in FINRA Rule 6730(a)(1)(A) through (C) chronologically (i.e., the reporting requirements for transactions that are executed at any time from midnight through 7:59:59 a.m. Eastern Time are in FINRA Rule 6730(a)(1)(A); the reporting requirements for transactions that are executed during TRACE system hours are in FINRA Rule 6730(a)(1)(B); and the reporting requirements for transactions executed less than 15 minutes before the TRACE system closes are in FINRA Rule 6730(a)(1)(C)).

 Under the legacy TRACE system, FINRA Rule 6730(d)(4)(B) required reporting a transaction that would settle on any day other than T + 3 with a specified settlement modifier.

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# Regulatory Notice

# 11-54

### **Branch Office Inspections**

FINRA and the SEC Issue Joint Guidance on Effective Policies and Procedures for Broker-Dealer Branch Inspections

### **Executive Summary**

FINRA and the Securities and Exchange Commission's Office of Compliance Inspections and Examinations are issuing the attached National Exam Risk Alert to provide broker-dealer firms with information on developing effective policies and procedures for branch office inspections. The Alert reminds firms of supervisory requirements under FINRA's supervision rule and notes common deficiencies and strong compliance practices.

Questions concerning this Notice should be directed to:

- Michael Rufino, Chief Operating Officer, Member Regulation Sales Practice, at (212) 858-4487; or
- ► George Walz, Vice President, Office of Risk, at (202) 728-8211.

### November 2011

### **Notice Type**

► Guidance

### **Suggested Routing**

- ► Compliance
- ► Internal Audit
- ► Risk
- ► Senior Management

### **Key Topics**

- ► Branch Office Inspections
- ► Risk Management
- ► Supervision

### Referenced Rules & Notices

- NASD Rule 3010
- ► NTM 98-96
- ► NTM 99-45





### National Examination Risk Alert

By the Office of Compliance Inspections and Examinations

in cooperation with the Financial Industry Regulatory Authority 1

Information for Managers and Chief Compliance Officers

In this Alert:

Topic: Broker-dealer branch

inspections

**Objectives:** Encourage firms to create effective policies and procedures for their branch inspections.

### Key Takeaways:

A broker-dealer's branch inspection program is a key part of its supervisory system.

Exam staff have found a number of deficiencies in branch inspections conducted by firms.

This Risk Alert presents a joint report by OCIE staff and FINRA staff, highlighting a number of practices that examiners have observed that are found in effective branch office supervisory systems.

Volume I, Issue 2 30, 2011

**November** 

### **Broker-Dealer Branch Inspections**

The branch inspection process is a critical component of a comprehensive risk management program and can help protect investors and the interests of the firm. OCIE and FINRA examination staff have observed that firms that execute this process well typically:

- tailor the focus of branch exams to the business conducted in that branch and assess the risks specific to that business;
- schedule the frequency and intensity of exams based on underlying risk, rather than on an arbitrary cycle, but examine branch offices at least annually;
- engage in a significant percentage of unannounced exams, selected through a combination of risk based analysis and random selection;
- deploy sufficiently senior branch office examiners who understand the business and have the gravitas to challenge assumptions; and
- design procedures to avoid conflicts of interest by examiners that may serve to undermine complete and effective inspection.

The Securities and Exchange Commission ("SEC"), as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the staff of the Office of Compliance Inspections and Examinations ("OCIE") in coordination with other SEC staff, including in the Division of Trading and Markets, and do not necessarily reflect the views of the Commission or the other staff members of the SEC. This document was prepared by OCIE staff in consultation with the staff of the Financial Industry Regulatory Authority ("FINRA") and is not legal advice.

Conversely, firms with significant deficiencies in the integrity of their overall branch inspection process, typically:

- utilize generic examination procedures for all branch offices, regardless of business mix and underlying risk;
- try to leverage novice or unseasoned branch office examiners who do not have significant depth of experience or understanding of the business to challenge assumptions;
- perform the inspection in a "check the box" fashion without questioning critically the integrity of underlying control environments and their effect on risk exposure;
- devote minimal time to each exam and little, if any, resources to reviewing the effectiveness of the branch office exam program;
- fail to follow the firm's own policies and procedures by not inspecting branch offices as required, announcing exams that were supposed to be unannounced, or failing to generate a written inspection report that included the testing and verification of the firm's policies and procedures, including supervisory policies and procedures;
- fail to have adequate policies and procedures, particularly in firms that use an independent contractor model and that allow registered personnel to also conduct business away from the firm; and
- lack heightened supervision of individuals with disciplinary histories or individuals previously associated with a firm with a disciplinary history.

A well-designed branch inspection program is both: (1) a necessary element (but not the only element) of a firm's compliance and reasonable supervision of its branch offices and branch office personnel under Section 15(b)(4)(E) of the Securities Exchange Act as well as FINRA rules; and (2) an integral component of the firm's risk management program. The branch inspection provides the firm with the opportunity to validate its surveillance results from branch offices and to gather on-site intelligence that supplements the ongoing management and surveillance of the branch from a business and risk management standpoint.

### **Risk-Based Inspections**

An effective risk assessment process will help drive the frequency, intensity and focus of branch office inspections; it should also serve as an important consideration in the decision to conduct the exam on an announced or unannounced basis. Therefore, branch offices should be continuously monitored with respect to changes in the overall business, products, people and practices. Branch inspections should be conducted by persons that have sufficient knowledge and experience to evaluate the activities of the branch, and should be overseen by senior personnel such as the CCO or other knowledgeable principal. Further, procedures should be designed to avoid conflicts of interest that may serve to undermine complete and effective inspections because of the economic, commercial or financial interests that an examiner holds in the associated person or branch being inspected.

Branch office inspections provide an opportunity for oversight that should enhance the firm's routine surveillance and supervisory activities. For instance, branch office inspections may allow a firm to better identify the nature and extent of outside business activities of registered branch office personnel. Outside business activities conducted by registered persons may carry added risk because these activities may be perceived by customers as part of the member's business. Confirming that the scope of outside business activities of registered branch office personnel

conform to those activities authorized by the firm is an important component of the branch office inspection, and addresses a risk that may be more difficult to monitor. For much the same reasons, unannounced inspections (which do not provide an opportunity to hide, alter or destroy documentation or other information reflecting such activities) are a critical element of any well designed branch office inspection program and should constitute a significant percentage of all exams conducted.

This ongoing risk analysis should be a key element of the firm's exam planning process and lead to more frequent examinations of offices posing higher levels of risk than dictated by the firm's non-risk based cycle, and lead firms to engage in more unannounced exams of such offices. Some areas of high risk to consider are: sales of structured products; sales of complex products, including variable annuities; sales of private or otherwise unregistered offerings of any type; or offices that associate with individuals with a disciplinary history or that previously worked at a firm with a disciplinary history. NASD IM-3010-1 also lists additional factors to consider in making this determination.

Pursuant to NASD Rule 3010(c)(2), each branch office inspection must include a written report that includes, at a minimum, testing and verification of the firm's policies and procedures in specified areas. As discussed further below, it is a good practice for this report to note any deficiencies and areas of improvement, as well as outline agreed-upon actions, including timelines, to correct the identified deficiencies.

### **Oversight of Branch Office Inspections**

A broker-dealer's internal branch inspection program is a necessary part of its supervisory system and a strong indicator of a firm's culture of compliance. To test the quality of broker-dealers' required inspections of branch offices, SEC and FINRA examiners may seek to review and verify items related to an effective branch examination program, particularly matters such as supervisory procedures regarding customer accounts and sales of retail products. For example, examiners may review the following:

- policies and procedures, including supervisory procedures as they pertain to the supervision of customer accounts, including those serviced by income producing managers;
- policies and procedures relating to the handling of money and securities physically received at the branch;
- validation of changes in customer addresses and other account information in accounts serviced by the branch;
- procedures related to transmittals of funds between customers and third parties, and between customers and registered representatives ("RRs");
- firm testing of policies and procedures related to specific retail products, including:
  - o sales of structured products;
  - o private and other unregistered offerings;
  - o municipal securities;
  - o mutual funds; and
  - o variable annuity sales and exchanges;
- firm testing in retail sales practice areas, including:

- o verification of customer account information;
- o supervision of customer accounts;
- o written supervisory procedures ("WSPs");
- o new account review, suitability of investments;
- o unauthorized trading;
- o churning;
- o allocations of new issues;
- o licensing; and
- o training;
- advertising and other communications with the public or with customers (such as email and other written correspondence) and compliance with approval procedures;
- evidence of unreported outside or other unauthorized business activities by review of: customer files, written materials on the premises and at any satellite locations, branch office accounting records, appointment books and calendars, phone records, bank records;
- procedures for handling of customer complaints;
- risk-based reviews of bank accounts of the branch and affiliated entities, third-party wire transfers, and branch signature guarantee log; and
- procedures to uncover use of unauthorized computers or other electronic devices and/or social media.

### Requirements and Guidance Pertaining to Broker-Dealer Branch Inspections

The responsibility of broker-dealers to supervise their associated persons is a critical component of the federal regulatory scheme. Sections 15(b)(4)(E) and 15(b)(6)(A) of the Exchange Act authorize the Commission to impose sanctions on a firm or any person that fails to reasonably supervise someone that is subject to the supervision of such firm or person who violates the federal securities laws. In order to defend such a charge, a broker-dealer could show that it has established procedures that would reasonably be expected to prevent and detect a violation by such other person, and has a system for applying such procedures that has been effectively implemented. Such a system must be designed in such a way that it could reasonably be expected to prevent and detect, insofar as practicable, securities law violations.

The staff of the SEC's Division of Trading and Markets (formerly known as the Division of Market Regulation) has noted that an effective branch office inspection program is a vital component of a supervisory system reasonably designed to oversee activities at remote branch offices.<sup>2</sup> A number of Commission decisions in the area, both settled and litigated, set forth principles that can guide firms in constructing an effective branch office inspection program.<sup>3</sup> Those cases suggest that regular branch office inspections over reasonably short intervals, including unannounced inspections, are the cornerstone of a well designed branch office

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Staff Legal Bulletin No. 17, Remote Office Supervision (March 19, 2004) ("SLB 17").

See, e.g., Consolidated Investment Services, Inc., Rel. No. 34-36687(Jan. 5, 1996) (where the Commission notes that: "We also agree with the law judge that surprise inspections of [the branch office] would have been a prudent course of action;" Signal Securities, Inc.,, Rel. No. 34-43350 (Sep. 26, 2000) ()(citing Consolidated Investment Services); and Quest Capital Strategies, Rel. No. 34-44935 (Oct. 15, 2001) ()(where the Commission stated that: "A surprise inspection is a compliance tool that is necessarily available to every securities firm in carrying out its supervisory responsibilities."); Royal Alliance Associates, Inc., Rel. No. 34-38174 (Jan. 15, 1997) ()(settled matter); see also SLB 17.

inspection program.<sup>4</sup> The Commission has sanctioned firms that have not conducted unannounced examinations of their branch offices. <sup>5</sup> Where a firm only conducts pre-announced examinations, that could create opportunities for branch office personnel to alter or destroy, documents, or commit other securities law violations, resulting in major fines for the firm.<sup>6</sup> As a result, OCIE and FINRA staff believe that a well-constructed branch office inspection program should include unannounced inspections, based on a combination of random selection, risk-based selection and for cause exams.

Beyond the timing and nature of the inspections, OCIE and FINRA staff also believe that past guidance suggests that a well-constructed branch office supervisory program should include: procedures for heightened supervision of remote branch offices that have associated persons with disciplinary histories; independent verification of the nature and extent of outside business activities; senior management's involvement in assuring that adequate procedures are in place and that sufficient resources are devoted to implementing those procedures; periodic reassessment of supervisory responsibilities; adequate delineation of supervisory responsibilities; periodic reassessment of supervisory responsibilities; thorough investigation and documentation of customer complaints; and a system of follow up and review of those and other red flags.<sup>7</sup>

FINRA rules and rule interpretations provide additional requirements and guidance in the area. NASD Rule 3010(b) requires every member broker-dealer to establish, maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of RRs, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable FINRA rules.

Notice to Members 99-45 instructs broker-dealers to adopt and implement a supervisory system that is "tailored specifically to the member's business and must address the activities of all its registered representatives and associated persons." Procedures that merely recite the applicable rules or fail to describe the steps the firm will take to determine compliance with applicable securities laws and regulations are not reasonable. A broker-dealer's procedures should instruct the supervisor on the requirements needed to be in compliance with the regulations. The

Id. at 295. See also NASD Notice to Members 98-96 (Dec. 1998).

See, e.g., Consolidated Investment Services, Inc., Rel. No. 34-36687(Jan.5, 1996); Signal Securities, Inc., Rel. No. 34-43350 (Sep. 26, 2000); Ouest Capital Strategies, Rel. No. 34-44935 (Oct. 15, 2001).

See, e.g., Quest Capital Strategies, Inc., Rel. No. 34-44935 (Oct. 15, 2001) and NYLIFE Securities Inc., Rel. No. 34-40459 (September 23, 1998) (settled matter).

See, e.g., Fidelity Brokerage Services, LLC, Rel. No. 34-50138 (Aug. 3, 2004) (pre-announced inspections resulted in, among other things, employees altering and destroying documents; sanctions included a \$1,000,000 fine payable to the SEC, plus a \$1,000,000 fine payable to the NYSE) (settled matter).

See, e.g., Prospera Financial Services, Admin. Pro. File No. 3-10306, Rel. No. 34-43352 (September 26, 2000) (settled matter) for a discussion of the above elements of a branch office supervisory program; see also SLB 17 for further discussion of these and other elements of an effective branch office supervisory system. See also NASD IM-3010-1 (Standards for Reasonable Review).

<sup>&</sup>lt;sup>8</sup> *NASD Notice to Members 99-45 (June 1999) at* 294.

NASD Notice to Members 99-45 (June 1999) at 293-94 (giving examples of situations in which "written supervisory procedures would instruct the supervisor" in how to document compliance)..

procedures should describe the activities the supervisor will conduct along with the frequency as to when the reviews will be conducted.<sup>11</sup>

NASD Rule 3010(c)(1) requires each member to conduct a review, at least annually, of the businesses in which it engages. A broker-dealer must conduct on-site inspections of each of its office locations; Office of Supervisory Jurisdictions ("OSJs")<sup>12</sup> and non-OSJ branches that supervise non-branch locations at least annually, all non-supervising branch offices at least every three years; and non-branch offices periodically. For these other branch offices, firms should consider whether a cycle of less than three years would be more appropriate, using factors such as the nature and complexity of the branch's securities business, the volume of business done, and the number of associated persons assigned to each branch. Pursuant to NASD Rule 3010(c)(1), broker-dealers must document the examination schedules for each non-supervisory branch and non-branch office in their WSPs, including a description of the factors used to determine the examination cycle for such locations. The rule also requires broker-dealers to record the dates each inspection was conducted.<sup>14</sup>

Pursuant to NASD Rule 3010(c)(2) the reports reflecting these reviews and inspections must be kept on file by the broker-dealer for a minimum of three years. NASD Rule 3010(c)(3) generally prohibits a branch office manager or any other person within the office with supervisory duties (or any person supervised by such person) from conducting an inspection of the office. <sup>15</sup>

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<sup>11</sup> *Id*.

An OSJ is defined under NASD Rule 3010(g) as any office of a member at which any one or more of the following functions take place: (a) order execution and/or market making; (b) structuring of public offerings or private placements; (c) maintaining custody of customers' funds and/or securities; (d) final acceptance (approval) of new accounts; (e) review and endorsement of customer orders; (f) final approval of advertising or sales literature, except for an office that solely conducts final approval of research reports; or, (g) responsibility for supervising the activities of associated persons at one or more other branch offices. NASD Rule 3010(c)(1)(B).

NASD Rule 3010(c), which governs "Internal Inspections," requires that each broker-dealer review the activities of each of its offices including the periodic examination of customer accounts to detect and prevent irregularities or abuses. The rule also requires that the written inspection report include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures in the following areas:

Safeguarding of customer funds and securities;

Maintaining books and records;

<sup>•</sup> Supervision of customer accounts serviced by branch office managers;

<sup>•</sup> Transmittal of funds between customers and RRs and between customers and third parties;

<sup>•</sup> Validation of customer address changes; and

<sup>•</sup> Validation of changes in customer account information.

However, the rule provides an exception from this requirement for a firm so limited in size and resources that it cannot otherwise comply. Under NASD Rule 3010(c)(3) the basis for this exception must be documented in the report for each inspection conducted in reliance on the exception.

### **Review of Effective Practices**

As noted throughout this Risk Alert, SEC and FINRA examiners have identified some practices that are characteristic of many effective supervisory procedures and effective branch office supervisory systems.<sup>16</sup> Such practices are consolidated here:

- Using risk analysis to identify whether individual non-supervising branches should be
  inspected more frequently than the FINRA-required minimum three-year cycle. Branches
  that meet certain risk criteria based on risk ratings are inspected more often. In addition,
  some firms conduct "re-audits" more frequently than required when routine inspections
  reveal a higher than normal number of deficiencies, repeat deficiencies or serious
  deficiencies. Typically, these re-audits and audits for cause are unannounced inspections.
- Using surveillance reports, employing current technology and techniques as appropriate, to help identify risk and develop a customized approach for the firm's compliance program and branch office inspections that considers the type of business conducted at each branch.
- Employing comprehensive checklists that incorporate previous inspection findings and trends from internal reports such as audit reports.
- Conducting unannounced branch inspections. Firms elected to conduct unannounced
  examinations either randomly or based on certain risk factors. These "surprise" exams
  may yield a more realistic picture of a broker-dealer's supervisory system, as it reduces
  the risk that individual RRs and principals might attempt to falsify, conceal or destroy
  records in anticipation for an internal inspection.
- Including in the written report of each branch inspection any noted deficiencies and areas
  of improvement. The report should also outline agreed upon actions, including timelines,
  to correct the identified deficiencies.
- Using examiners with sufficient experience to understand the business being conducted at the particular branch being examined and the gravitas to challenge assumptions.
- Designing procedures to avoid conflicts of interest by examiners that may serve to undermine complete and effective inspection.
- Involving qualified senior personnel in several branch office examinations per year.
- Incorporating findings on results of branch office inspections into appropriate management information or risk management systems; and using a compliance database that enables compliance personnel in various offices to have centralized access to comprehensive information about all of the firm's RRs and their business activities. Such a system appears to be highly useful to the compliance personnel at the OSJ and elsewhere for quickly accessing information and for supervising independent contractor RRs dispersed across a broad geographic area.
- Providing branch office managers with the firm's internal inspection findings and requiring them to take and document corrective action.

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Firms are encouraged to consider the practices described herein in assessing their own procedures and implementing improvements that will best protect their clients. Firms are cautioned that these factors and suggestions are not exhaustive, and they constitute neither a safe harbor nor a "checklist" for SEC staff examiners. Other practices besides those highlighted here may be appropriate as alternatives or supplements to these practices. While some of the effective practices above are existing regulatory requirements, the adequacy of a supervisory program can be determined only with reference to the profile of the specific firm and the specific facts and circumstances.

- Tracking corrective action taken by each branch office manager in response to branch audit findings.
- Elevating the frequency and/or scope of branch inspections where registered personnel are allowed to conduct business activities other than as associated persons of a broker-dealer, for example away from the firm.

### **Conclusion**

This alert reminds broker-dealers that their branch office inspections must be conducted with vigilance. It describes certain supervisory tools that, based on OCIE and FINRA staff examinations and Commission enforcement cases, are characteristic of good supervisory procedures for branch office inspections, including the use of unannounced onsite inspections. While this alert summarizes recognized precedent and standards, and provides OCIE and FINRA staff views with regard to means to enhance branch inspections, it does not provide an exhaustive list of steps to effectively discharge responsibilities. A well-designed branch office inspection program is a necessary element – but not the only element – of reasonable supervision of a firm's branch offices and branch office personnel.

We recognize that each firm is different and that firms need flexibility to adopt procedures to suit their individual structures and business needs. Our suggestions as to compliance methods are not meant to be exclusive or exhaustive and do not constitute a safe harbor. Rather, this report may assist firms in crafting more effective policies and procedures for branch office inspections to prevent and detect misconduct. We urge firms to review their policies and procedures in this regard to determine if they are reasonably designed to prevent and detect violations of applicable law and rules.

# Trade Reporting Notice

# Asset-Backed Securities Transaction Reporting Pilot Program Expires November 18, 2011

### **Executive Summary**

A TRACE pilot program, which requires a firm to report a transaction in an asset-backed security no later than the business day following the date of execution, will expire on November 18, 2011.¹ Upon expiration of the program, most transactions in asset-backed securities must be reported the day of execution during TRACE system hours.

Questions regarding this *Notice* should be directed to:

- Patrick Geraghty, Director, Market Regulation, at (240) 386-4973;
- ► Elliot R. Levine, Associate Vice President and Counsel, Transparency Services, at (202) 728-8405; or
- Sharon Zackula, Associate Vice President and Associate General Counsel, OGC, at (202) 728-8985

#### Discussion

FINRA reminds firms that the pilot program in FINRA Rule 6730(a)(3)(A)(i), which requires a firm to report a transaction in an asset-backed security no later than the business day following the date of execution (T + 1), will expire on Friday, November 18, 2011, at 11:59:59 p.m. Eastern Time (ET). After the pilot program expires, firms must report transactions in asset-backed securities that are executed on a business day before 5 p.m. ET on the date of execution (T) during TRACE system hours, as provided in Rule 6730(a)(3) (A)(ii). The general requirement in Rule 6730(a)(3)(A)(ii) is supplemented by reporting requirements in FINRA Rule 6730(a)(3)(B)(i) and (ii), which apply to asset-backed securities transactions executed near the close of TRACE system hours on a business day, after the TRACE system closes on a business day and on non-business days.

Although collateralized mortgage obligations (CMOs) and real estate mortgage investment conduits (REMICs) are asset-backed securities as defined in FINRA Rule 6710(m), certain pre-issuance transactions in CMOs and REMICs are subject to the reporting provisions in Rule 6730(a)(3)(C) instead of the reporting requirements generally applicable to asset-backed securities

### November 7, 2011

### **Key Topics**

- ► Asset-Backed Securities
- Pilot Program Expiration
- ▶ Transaction Reporting

### Referenced Rules & Notices

► FINRA Rule 6730



### November 7, 2011

in Rule 6730(a)(3)(A) and (B). Upon the expiration of the Pilot Program, pre-issuance transactions in CMOs and REMICs must be reported in accordance with Rule 6730(a)(3)(C) (ii), which requires a firm to report the earlier of:

- the business day that the security is assigned a CUSIP, a similar numeric identifier or a FINRA symbol during TRACE system hours (unless the identifier is assigned after 1 p.m. ET, and in that case, the transactions must be reported no later than the next business day during TRACE system hours); or
- ▶ the date of issuance of the security during TRACE system hours.

In either case, if the transaction is reported other than on the date of execution, the transaction report must be designated "as/of" and include the date of execution.

### **Endnote**

 See Rule 6730(a)(3)(A)(i). However, as discussed below, Rule 6730(a)(3)(A)(i) is not applicable to asset-backed securities transactions that are certain pre-issuance transactions in collateralized mortgage obligations (CMOs) and real estate mortgage investment conduits (REMICs).

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# Information Notice

### **Continuing Education**

Changes to FINRA's S201 Regulatory Element Continuing Education Program

On January 2, 2012, FINRA will implement a redesigned version of the S201 Regulatory Element Program in an effort to improve and keep the Continuing Education Program current and relevant. The S201 Regulatory Element Program (*i.e.*, the Supervisors Program) is required for supervisory/principal registrants.

Individuals who schedule an S201 session on or after January 2 will see the redesigned program, which includes new story-based cases and an updated user interface. The new program, which has been streamlined to include only four modules, integrates a range of topics, such as ethics and business conduct, compliance, registration/licensing and reporting requirements. Individuals must demonstrate their proficiency in the content of each case in order to successfully complete a module.

To help individuals become familiar with the revised program, FINRA has made available online the related content outline, an animated orientation and brief sample case.

The registration process for the S201 Regulatory Element Program remains unchanged. Individuals may continue to register online for sessions through the Pearson and Prometric test center websites or by telephone.

Further information about the S201 Regulatory Element redesigned program, including how to register, is available at <a href="https://www.finra.org/ce/training">www.finra.org/ce/training</a>.

Questions about this Notice may be directed to:

- ▶ John Kalohn, Vice President, Testing and Continuing Education, at (240) 386-5800; or
- ▶ Roni Meikle, Director, Continuing Education, at (646) 315-8688.

### November 28, 2011

### **Suggested Routing**

- ▶ Compliance
- ► Continuing Education
- ► Registered Representatives
- ► Registration
- ► Training

### **Key Topics**

- ► Continuing Education
- ► Regulatory Element Program



## **Election Notice**

### FINRA Announces Results of the Small Firm Advisory Board and District Committee Elections

### **Executive Summary**

FINRA recently concluded elections to fill vacant seats on the Small Firm Advisory Board (SFAB) and District Committees. This *Notice* lists the individuals elected to fill vacant seats on the SFAB and those elected and appointed to District Committees for terms beginning January 1, 2012.

Questions concerning this *Election Notice* may be directed to:

- Marcia Asquith, Senior Vice President and Corporate Secretary, at (202) 728-8949; or
- ▶ Chip Jones, Senior Vice President, Member Relations, at (240) 386-4797.

### Small Firm Advisory Board Election Results

FINRA small firms in the Midwest and South Regions elected the following individuals to fill open seats on the SFAB:

### **South Region**

David W. Wiley, III, Wiley Bros.—Aintree Capital, LLC

### **Midwest Region**

Eric A. Bederman Bernardi Securities, Inc.

The elected individuals will serve a three-year term beginning January 1, 2012.

### **November 29, 2011**

### **Suggested Routing**

- Executive Representative
- Senior Management



### **District Committees**

The following individuals were elected or appointed to serve on FINRA District committees and will serve three-year terms beginning January 1, 2012.

District 1:

Small Firm Representative: Alan Carlisle, Hanson McClain

Mid-Size Firm Representative: Stephen Chipman, Foothill Securities, Inc.

Large Firm Representative: Bill Hatcher, Wells Fargo Advisors, LLC

District 2:

Small Firm Representative: Cynthia Aragon, WestPark Capital, Inc.

Mid-Size Firm Representative: Houston A. Goddard, Girard Securities, Inc.

Large Firm Representative: Kathleen D. VanNoy-Pineda, LPL Financial

District 3:

Small Firm Representative: Chester Hebert, Colorado Financial Service Corporation

Mid-Size Firm Representative: Jodee Brubaker-Rager, Geneos Wealth Management

Large Firm Representative: Lance Wells, Metropolitan Life Insurance Company

District 4:

Small Firm Representative: J. Daniel Stepp, Central States Capital Markets, LLC

Mid-Size Firm Representative: Chad Estep, Century Securities Associates, Inc.

Large Firm Representative: Terry L. Lister, Waddell & Reed, Inc.

District 5:

Small Firm Representative: Carolyn May, Simmons First Investment Group, Inc.

Mid-Size Firm Representative: Rush F. Harding III, Crews & Associates, Inc.

Large Firm Representative: Patrick Dogan, Sterne, Agee & Leach, Inc.

District 6:

Small Firm Representative: Darla K. Bartkowiak, Amherst Securities Group, LP

Mid-Size Firm Representative: David W. Stringer, Prospera Financial Services, Inc.

Large Firm Representative: Christine L. Staib, LPL Financial

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District 7:

Small Firm Representative: Jim R. Webb, Cape Securities Inc.

Mid-Size Firm Representative: Brian Kovack, Esq., Kovack Securities, Inc.

Large Firm Representative: Ken Muraoka, FSC Securities

**District 8:** 

Small Firm Representative: Gina Bokios, Regal Securities, Inc.

Mid-Size Firm Representative: Lynn Goebel, ValMark Securities, Inc.

Large Firm Representative: Erwin J. Dugasz, Jr., Nationwide Investment Services

Corporation

District 9:

Small Firm Representative: Victoria Bach-Fink, Wall Street Financial Group, Inc.

Mid-Size Firm Representative: Robert Dow, Lord Abbett Distributor

Large Firm Representative: Nancy L. Heffner, Lincoln Investment Planning, Inc.

District 10:

Small Firm Representatives: Myles J. Edwards, Constellation Wealth Advisors LLC

David M. Sobel, Esq., Abel/Noser Corp.

Mid-Size Firm Representative: Rebecca Ebert, Sandler O'Neill

Large Firm Representatives: Joseph Neary, Royal Alliance Associates, Inc.

Douglas G. Preston, Merrill Lynch, Pierce, Fenner & Smith,

Incorporated

District 11:

Small Firm Representative: John I. Fitzgerald, Leerink Swann LLC

Mid-Size Firm Representative: Steve Buff, Columbia Management

Large Firm Representative: Paul J. Tolley, Commonwealth Financial Network

**Endnote** 

1. Pursuant to FINRA By-laws, FINRA appoints a representative to fill an open seat if no candidate self-nominates to run for an open seat.

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