

INFORMATIONAL

Registration Of Chief Compliance Officers

SEC Approves NASD Rule Proposal Requiring Registration Of Chief Compliance Officers; Effective Date: January 1, 2002

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Executive Representatives
- Legal & Compliance
- Operations
- Senior Management

KEY TOPICS

- Chief Compliance Officers
- Continuing Education/Testing/Qualifications
- Registration

Executive Summary

On June 19, 2001, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD®) Rule 1022(a), "General Securities Principal."¹ These changes will require the chief compliance officer designated on Schedule A of a member's Form BD to be registered as a general securities principal unless the member's activities are limited to particular areas of the investment banking or securities business. In that case, the individual may apply for a limited principal registration. Acceptable limited principal categories for a chief compliance officer are the Limited Principal Investment Company and Variable Contracts Products (Series 26), Limited Principal Direct Participation Programs (Series 39), and the Government Securities Principal, if the activities of the chief compliance officer's firm are limited to these areas. NASD Regulation will accept, in lieu of any of these NASD principal examinations, the New York Stock Exchange (NYSE) Series 14 Compliance Official examination.

The amendments also permit individuals who have been listed continuously as a firm's chief compliance officer for the two years preceding January 1, 2002, to be grandfathered, *i.e.*, not be required to take a principal examination, provided they have no disciplinary history as specified in Rule 1022(a).

The text of the amendments as provided in Attachment A becomes effective on January 1, 2002.

Questions/Further Information

Questions concerning this *Notice* may be directed to Carole B.

Hartzog, Qualifications Department, Department of Member Regulation, NASD Regulation, Inc., at (240) 386-4678; John J. Linnehan, Director, Continuing Education Department, Department of Member Regulation, NASD Regulation, Inc., at (240) 386-4684; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8844.

Discussion

This rule change requires the chief compliance officer designated on Schedule A of a member's Form BD to be registered as a Series 24 General Securities Principal.² If the member's activities are limited to particular areas of the investment banking or securities business, the chief compliance officer may apply for a limited principal registration. Acceptable limited principal categories for a chief compliance officer are the Limited Principal Investment Company and Variable Contracts Products (Series 26), Limited Principal Direct Participation Programs (Series 39), and Government Securities Principal.³ To avoid imposing duplicative examination requirements on dual NASD/NYSE members, NASD Regulation will accept, for purposes of chief compliance officer registration, the NYSE Series 14 Compliance Official examination in lieu of the NASD Series 24, Series 26, or Series 39 principal examinations.⁴ Any person who is listed as the chief compliance officer on the Form BD who is not already registered as a principal will be required to apply for principal registration and pass the appropriate examination within 90 calendar days of January 1, 2002, the effective date of the rule change. Likewise, any person who becomes a chief compliance

officer for the first time on or after January 1, 2002, will also be required to apply for principal registration and pass the required examination. All persons, including chief compliance officers, who are required to take a principal examination must take any prerequisite examination.

Grandfathering Provision

The rule change also permits certain chief compliance officers to be “grandfathered,” *i.e.*, to register and qualify as a principal without having to take the appropriate qualification examination. The grandfathering provision applies only to the chief compliance officer function. A person who has been continuously designated as a chief compliance officer on Schedule A of Form BD from January 1, 2000 through January 1, 2002, will not be required to pass the appropriate qualification examination, provided that he or she has not been subject within the last 10 years to: any statutory disqualification as defined in Section 3(a)(39) of the Securities Exchange Act of 1934, as amended; a suspension; or the imposition of a fine of \$5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding. A chief compliance officer who has been employed continuously but by more than one firm during the grandfathering period should contact NASD Regulation’s Qualifications Department to determine whether they qualify for the grandfathering provision or whether they are eligible for a

waiver of the applicable examination requirement pursuant to NASD Rule 1070(e).

Limited Principal Registration

A chief compliance officer who becomes registered as a limited principal, *i.e.*, a Limited Principal Investment Company and Variable Contracts Products (Series 26), Limited Principal Direct Participation Programs (Series 39), or a Government Securities Principal, either by examination or grandfathering, must restrict his or her activities to those permitted by such registration category unless he or she thereafter becomes registered in some other principal category. If a chief compliance officer who has been registered as a limited principal, either by examination or by grandfathering, wishes to serve as a principal for any other function, he or she must be appropriately qualified and registered. For example, a Series 26 Limited Principal who later becomes the chief compliance officer at a full-service firm must requalify by taking the Series 24 or Series 14 examination.

Continuing Education Requirement

All chief compliance officers, including those that have been “grandfathered,” will be subject to all applicable continuing education requirements. Accordingly, chief compliance officers will generally be subject to the Regulatory Element requirements by virtue of the fact that they are registered persons. Firm Element requirements will apply to those whose activities deem them to be “covered registered persons.”

Registration Requirements Of Chief Compliance Officers Who Are Also General Counsels

Under this rule change, all chief compliance officers, including those who also serve as a firm’s general counsel, must be registered in a principal capacity. It is incumbent upon a member firm that employs an attorney to serve as both the general counsel and chief compliance officer to provide for the appropriate separation of these functions. The NASD has a mandatory statutory obligation to ensure compliance with its rules and the federal securities laws, and member firms are obligated to cooperate with the NASD in its investigations and actions to ensure compliance.

Registration Requirements Of General Counsels Who Are Not Chief Compliance Officers

The chief compliance officer registration requirement does not change the current requirement that any individual, including a firm’s general counsel, who is involved in the day-to-day management of the firm’s business or who has management-level responsibilities for supervising any aspect of the member’s investment banking or securities business is required to be registered as a principal. NASD Regulation determines whether an individual is involved in the management of a member firm on a case-by-case basis, regardless of whether the concerned individual is also the firm’s general counsel. As described in *NASD Notice to Members 99-49* (providing interpretive guidance on registration requirements), a firm’s general counsel who solely

provides legal advice and does not participate in the management of the member or have management-level supervisory responsibilities is not required to register in a principal capacity. In addition, a member's general counsel may advise the firm's executive, management, or operations committees and avoid triggering the registration requirement if he or she only provides counsel and does not vote.

Registration Procedures

To register a chief compliance officer as a principal:

- Members must file a Form U-4 on Web CRD for the candidate to request registration as a General Securities Principal or other acceptable limited principal registration determined by the scope of the member's securities business.
- The candidate must take the appropriate prerequisite and principal exams within 90 days of January 1, 2002.⁵

To register a chief compliance officer as a principal under the grandfathering provision:

- Members must file a Form U-4 on Web CRD for the candidate to request registration as a General Securities Principal or other acceptable limited principal registration determined by the scope of the member's securities business.
- In addition to filing the Form U-4, members also must provide a statement indicating that the candidate has been designated as the firm's chief compliance officer on Schedule A of the Form BD for at least two years

immediately prior to January 1, 2002. (If the candidate has been designated as the chief compliance officer for more than one firm during the two years immediately prior to January 1, 2002, that information also should be provided.) The request must be signed by a principal of the firm and sent to:

**Waiver Coordinator
NASD Regulation, Inc.
Testing and Continuing
Education Department
9509 Key West Avenue
Rockville, MD 20850**

To register a chief compliance officer who is an NYSE Series 14 compliance official as a principal:

- A joint NASD/NYSE member firm may request a waiver of the Series 24 General Securities Principal examination for persons who have passed the Series 14 Compliance Official examination and are properly registered with the NYSE. The member must file a Form U-4 on Web CRD for the candidate to request registration as a General Securities Principal or other limited principal registration determined by the scope of the member's securities business.
- In addition to filing the Form U-4, members also must provide a statement indicating that the candidate is designated as the firm's chief compliance officer on Schedule A of the Form BD. The request must be signed by a principal of the firm and sent to the Waiver Coordinator at the above address.
- A chief compliance officer who does not qualify for the grandfathering provision, but who wishes to request an

examination waiver, must submit a written request for waiver from the qualification examination requirement, signed by a principal of the firm, to the Waiver Coordinator at the above address.

Effective Date Of Amendments

These amendments become effective on January 1, 2002.

Endnotes

- 1 See Securities Exchange Act Release No. 44451 (June 19, 2001), 66 FR 33985 (June 26, 2001) (File No. SR-NASD-99-46) ("SEC Approval Order").
- 2 The chief compliance officer registration requirement does not create the presumption that a chief compliance officer has supervisory responsibilities or is otherwise a control person. As in the past, NASD Regulation will hold a chief compliance officer responsible for supervision only where supervision is his or her responsibility. Many chief compliance officers are already registered as principals. NASD Regulation does not presume that these individuals have supervisory responsibility by virtue of their title. NASD Regulation will continue to determine whether a chief compliance officer is acting in a supervisory capacity based on the actual responsibilities and functions that the chief compliance officer performs for the firm.
- 3 Chief compliance officers for member firms limited to options activities cannot take the Series 4 exam (Registered Options Principal) in order to satisfy the chief compliance officer principal registration requirement. Also, because there is no qualifying examination for government securities principals, government securities principals are only required to register as such.
- 4 For example, if a person has a NYSE Series 14 license, and after January 1, 2002, accepted a chief compliance officer position with an NASD member, the person would not be required to take the Series 24 examination. In addition, if a person becomes a chief compliance officer for the first time after the effective date of the proposed rule change for a dual NASD/NYSE member, that person may elect to take the NYSE Series 14 exam in lieu of the NASD Series 24 exam.
- 5 The Registration/Exam Fee Schedule may be found on the NASD Regulation Web Site (www.nasdr.com).

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ATTACHMENT A – RULE TEXT

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

1022. Categories of Principal Registration

(a) General Securities Principal

(1) Each person associated with a member who is included within the definition of principal in Rule 1021, and each person designated as a Chief Compliance Officer on Schedule A of Form BD, shall be required to register with the Association as a General Securities Principal and shall pass an appropriate Qualification Examination before such registration may become effective unless [his] such person's activities are so limited as to qualify [him] such person for one or more of the limited categories of principal registration specified hereafter. A person whose activities in the investment banking or securities business are so limited is not, however, precluded from attempting to become qualified for registration as a General Securities Principal, and if qualified, may become so registered. Each person seeking to register and qualify as a General Securities Principal must, prior to or concurrent with such registration, become registered, pursuant to the Rule 1030 Series, either as a General Securities Representative or as a Limited Representative-Corporate Securities. A person who has been designated as a Chief Compliance Officer on Schedule A of Form BD for at least two years immediately prior to January 1, 2002 and who has not been subject within the last ten years to any statutory disqualification as defined in Section 3(a)(39) of the Act; a suspension; or the imposition of a fine of \$5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding shall be required to register as a General Securities Principal, but shall be exempt from the requirement to pass the appropriate Qualification Examination. If such person has acted as a Chief Compliance Officer for a member whose business is limited to the activities described in Rule 1022(d)(1)(A) or Rule 1022(e)(2), he or she shall be exempt from the requirement to pass the appropriate Qualification Examination only if he or she registers as a Limited Principal pursuant to Rules 1022(d) or Rule 1022(e), as the case may be, and restricts his or her activities as required by such registration category. A Chief Compliance Officer who is subject to the Qualification Examination requirement shall be allowed a period of 90 calendar days following January 1, 2002 within which to pass the appropriate Qualification Examination for Principals.

(a)(2) through (a)(6) No change

(b) through (g) No changes