

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83863; File No. SR-FINRA-2018-031]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend FINRA Rule 1220(a)(4), Financial and Operations Principal and Introducing Broker-Dealer Financial and Operations Principal

August 16, 2018.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 15, 2018, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

FINRA is proposing to amend FINRA Rule 1220(a)(4) (Financial and Operations Principal and Introducing Broker-Dealer Financial and Operations Principal) to: (1) Reflect that certain firms remain exempt from the requirement to designate an individual as a Financial and Operations Principal (“FINOP”) or an Introducing Broker-Dealer Financial and Operations Principal (“Introducing FINOP”); and (2) provide that the individual designated as Principal Financial Officer and Principal Operations Officer of these exempt firms is not required to be qualified and registered as a FINOP or an Introducing FINOP.

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

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

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

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

###### 1. Purpose

In July 2017, the SEC approved a proposed rule change to,<sup>4</sup> among other things, adopt the NASD and Incorporated NYSE rules<sup>5</sup> relating to individuals responsible for a member’s financial and operational activities as FINRA Rule 1220(a)(4) in the Consolidated FINRA Rulebook.<sup>6</sup> The rule change will become effective on October 1, 2018.<sup>7</sup>

Subparagraph (A) of FINRA Rule 1220(a)(4) requires that each firm designate an individual as a FINOP or an Introducing FINOP to carry out specified financial and operational

<sup>4</sup> See Securities Exchange Act Release No. 81098 (July 7, 2017), 82 FR 32419 (July 13, 2017) (Order Approving File No. SR-FINRA-2017-007). For ease of reference, FINRA revised the titles of some of the registration categories as part of SR-FINRA-2017-007. For instance, FINRA changed “Limited Principal—Financial and Operations” and “Limited Principal—Introducing Broker/Dealer Financial and Operations” to “Financial and Operations Principal” and “Introducing Broker-Dealer Financial and Operations Principal,” respectively. This proposed rule change refers to the titles that were approved as part of SR-FINRA-2017-007, though the changes are not yet effective.

<sup>5</sup> Current NASD Rules 1022(b) (Limited Principal—Financial and Operations) and 1022(c) (Limited Principal—Introducing Broker/Dealer Financial and Operations) and Incorporated NYSE Rule Interpretations 311(b)(5)/02 (Examination Requirements for Chief Financial Officers (“CFO”) and Chief Operations Officers (“COO”)) and/03 (Dual Designation of CFO and COO).

<sup>6</sup> The current FINRA rulebook consists of: (1) FINRA rules; (2) NASD rules; and (3) Incorporated NYSE rules. While the NASD rules generally apply to all FINRA members, the Incorporated NYSE rules apply only to those members of FINRA that are also members of the NYSE (“dual members”). The FINRA rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see *Information Notice*, March 12, 2008 (Rulebook Consolidation Process).

<sup>7</sup> See *Regulatory Notice 17-30* (SEC Approves Consolidated FINRA Registration Rules, Restructured Representative-Level Qualification Examinations and Changes to Continuing Education Requirements) (October 2017).

responsibilities,<sup>8</sup> including, for example, supervision of individuals who assist in the preparation of financial reports. Such individuals must pass the FINOP examination (Series 27) or Introducing FINOP examination (Series 28), as applicable, or obtain a waiver of the examination. They must also register in the Central Registration Depository (“CRD”<sup>®</sup>) system with the designation FN (for FINOP) or FI (for Introducing FINOP).

Certain members, hereinafter referred to as exempt firms, are exempt from the requirement in current NASD Rules 1022(b) and 1022(c) to designate an individual as a FINOP or an Introducing FINOP to carry out specified financial and operational responsibilities, including from the requirement that such an individual pass the Series 27 or Series 28 examination (or obtain a waiver of the examination) and register in the CRD system with the designation FN or FI.<sup>9</sup> FINRA preserved these exemptions when it proposed to adopt FINRA Rule 1220(a)(4)(A).<sup>10</sup> However, these exemptions were not reflected in the rule text.

Subparagraph (B) of FINRA Rule 1220(a)(4) requires each firm to designate an individual as Principal Financial Officer with primary responsibility over the firm’s financial filings and the related books and records and an individual as Principal Operations Officer with primary responsibility over the firm’s day-to-day operations. Such individuals must also pass the Series 27 or Series 28 examination, as applicable, or obtain a waiver of the examination. Further, they must register in the CRD system with the designation FN or FI. The responsibilities of a designated Principal Financial Officer and Principal Operations Officer intersect with the responsibilities of a designated FINOP or Introducing FINOP. However,

<sup>8</sup> The determination of whether a firm is eligible to designate an Introducing FINOP, rather than a FINOP, depends on the firm’s minimum net capital requirements.

<sup>9</sup> See Securities Exchange Act Release No. 44332 (May 21, 2001), 66 FR 29196, 29197 (May 29, 2001) (Order Approving File No. SR-NASD-00-77). See also *Notice to Members (“NTM”)* 01-52 (SEC Approves NASD Rule Proposal Relating To Registration Requirements For Limited Principals-Financial And Operations And Limited Principals-Introducing Broker/Dealer Financial And Operations) (August 2001).

<sup>10</sup> See Securities Exchange Act Release No. 80371 (April 4, 2017), 82 FR 17336, 17338, n.12 (April 10, 2017) (Notice of Filing of File No. SR-FINRA-2017-007) (stating that “[t]hose members that are currently exempt from the requirement to have a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal based on an exemption granted to them prior to September 17, 2001 will continue to be exempt from this requirement.”).

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

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

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

the responsibilities of a designated FINOP or Introducing FINOP are more specific in nature (e.g., they are required to supervise individuals who assist in the preparation of financial reports). In addition, a member's designated FINOP or Introducing FINOP is eligible to perform the responsibilities of a Principal Financial Officer and a Principal Operations Officer.

As stated in *Regulatory Notice* 17–30, the requirement to designate a Principal Financial Officer and Principal Operations Officer applies to all firms, including exempt firms. As a result, by October 1, 2018, exempt firms would have been required to designate as Principal Financial Officer and Principal Operations Officer an individual who is qualified and registered as a FINOP or an Introducing FINOP (i.e., the individual must have passed the Series 27 or Series 28 examination (or obtained a waiver of the examination) and registered in the CRD system with the designation FN or FI).

Exempt firms have noted that the responsibilities of a Principal Financial Officer and a Principal Operations Officer are functional equivalents to the responsibilities that a designated FINOP or Introducing FINOP would carry out at their firms. Exempt firms have also noted that, given their exempt status, they do not have an individual designated as a FINOP or an Introducing FINOP to whom to assign the responsibilities of a Principal Financial Officer and Principal Operations Officer. Similarly, they do not have any other associated persons who are qualified and registered as a FINOP or an Introducing FINOP (e.g., individuals who have passed the Series 27 examination and registered in the CRD system with the designation FN) to whom to assign the specified responsibilities.

Therefore, exempt firms have stated that FINRA Rule 1220(a)(4)(B) would have the indirect impact of eliminating their FINOP and Introducing FINOP exemptions by requiring them to designate an individual who is qualified and registered as a FINOP or an Introducing FINOP to carry out responsibilities that are functionally equivalent to those responsibilities that would otherwise be carried out by a designated FINOP or Introducing FINOP.

FINRA recognizes that the rule change would have the impact of eliminating longstanding exemptions that were granted to members, which was not the intended purpose of the rule change. The purpose of the rule change is to ensure that each member has designated individual(s) with primary

responsibility for specified financial and operational functions carried out by the firm.

Accordingly, FINRA is proposing to amend FINRA Rule 1220(a)(4)(A) to reflect that exempt firms remain exempt from the requirements of FINRA Rule 1220(a)(4)(A). FINRA is also proposing to amend FINRA Rule 1220(a)(4)(B) to provide that individuals designated as Principal Financial Officers and Principal Operations Officers of exempt firms are not required to be qualified and registered as FINOPs or Introducing FINOPs. FINRA Rule 1220(a)(4)(B) would continue to require exempt firms to designate an individual as a Principal Financial Officer and Principal Operations Officer to carry out specified financial and operational responsibilities, but such individual would not be required to be qualified and registered as a FINOP or an Introducing FINOP.<sup>11</sup>

Finally, as indicated in *NTM* 01–52, FINRA reserves the right to require exempt firms to designate an individual as a FINOP or an Introducing FINOP to carry out specified financial and operational responsibilities if changes occur in the circumstances under which the original exemption was granted, such as a substantial increase in business or the addition of new lines of business. FINRA also may require exempt firms to designate an individual as a FINOP or an Introducing FINOP if FINRA determines that there is a material financial-related examination finding that would necessitate it. However, in the case of any of these events, the member would have the right to appeal such actions pursuant to FINRA Rule 9630 (Appeal). In addition, FINRA may impose a disciplinary sanction that would require exempt firms to designate an individual as a FINOP or an Introducing FINOP. In the event that a member is no longer exempt under the circumstances described above, the firm would also have to ensure that the individual designated as Principal Financial Officer and Principal Operations Officer is qualified and registered as a FINOP or an Introducing FINOP.

FINRA is filing the proposed rule change for immediate effectiveness. The implementation date will be October 1, 2018, to coincide with the implementation date of the consolidated registration rules.

<sup>11</sup> In addition, FINRA notes that individuals designated as Principal Financial Officers and Principal Operations Officers of exempt firms would likely be required to be qualified and registered as principals, such as General Securities Principals, given the scope of their responsibilities.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>12</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes it is appropriate to continue to provide an exemption under FINRA Rule 1220(a)(4) to those firms that were previously granted an exemption from the requirement to designate an individual as a FINOP or an Introducing FINOP to carry out specified financial and operational responsibilities. FINRA also believes the proposed rule change strikes an appropriate balance in that exempt firms would still be required to designate an individual as a Principal Financial Officer and Principal Operations Officer to carry out specified financial and operational responsibilities, though the individual would not have to be qualified and registered as a FINOP or an Introducing FINOP.

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

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

### *Economic Impact Assessment*

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the regulatory need for the proposed rule change, the economic baseline of analysis, the economic impact and the alternatives considered.

### *Regulatory Need*

Exempt firms are not required to designate an individual as a FINOP or an Introducing FINOP to carry out specified financial and operational responsibilities. The requirements under FINRA Rule 1220(a)(4)(B), which become operative on October 1, 2018, would effectively and unintentionally undo these exemptions. FINRA is therefore preserving these exemptions, while ensuring that each FINRA member, including exempt firms, has a designated Principal Financial Officer and Principal Operations Officer to carry out specified financial and operational responsibilities.

<sup>12</sup> 15 U.S.C. 78o–3(b)(6).

## Economic Baseline

The economic baseline for the proposed rule change relates to the activities and costs associated with financial and operational controls conducted by exempt firms. There are approximately 140 current exempt firms.

## Economic Impact

For purposes of this discussion, FINRA has identified the potentially material impacts of the proposed rule change.

## Impact on Firms and Associated Persons

The proposed rule change would preserve the ability of exempt firms to maintain financial and operational controls without the addition of a designated individual as FINOP or Introducing FINOP. Relative to current practices, the proposed rule change would not impose material costs on members or associated persons. However, the proposed rule change would eliminate, or significantly reduce, the operational, administrative and cost burden on exempt firms once FINRA Rule 1220(a)(4)(B) becomes effective.

Among other benefits, exempt firms would not be required to employ, or otherwise associate with, an individual who is currently qualified and registered as a FINOP or an Introducing FINOP by October 1, 2018 to carry out the responsibilities of Principal Financial Officer and Principal Operations Officer. Alternatively, exempt firms would not be required to ensure that a current associated person is qualified and registered as a FINOP or an Introducing FINOP by October 1, 2018 to carry out the responsibilities of Principal Financial Officer and Principal Operations Officer. The proposed rule change would also reduce the costs and burdens on current associated persons of exempt firms who will be designated as Principal Financial Officers and Principal Operations Officers because such individuals would not be required to qualify and register as FINOPs or Introducing FINOPs.

The proposed rule change would not alter the obligations of members that are currently required to have a designated individual as FINOP or Introducing FINOP. As noted above, a firm's designated FINOP or Introducing FINOP is eligible to perform the responsibilities of a Principal Financial Officer and a Principal Operations Officer.

## Impact on Customers of Exempt Firms

The proposed rule change is not expected to materially alter the

protections that customers of exempt firms currently receive.

## Alternatives Considered

FINRA considered whether alternative qualifications and registrations would be appropriate for Principal Financial Officers and Principal Operations Officers, other than qualification and registration as a FINOP or an Introducing FINOP. However, FINRA determined not to adopt an alternative qualification and registration requirement pending its evaluation of the structure of its principal-level examinations.

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

Written comments were neither solicited nor received.

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

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

## IV. Solicitation of Comments

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

### Electronic Comments

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2018-031 on the subject line.

### Paper Comments

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

All submissions should refer to File Number SR-FINRA-2018-031. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2018-031, and should be submitted on or before September 12, 2018.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

**Eduardo A. Aleman,**

*Assistant Secretary.*

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<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 17 CFR 240.19b-4(f)(6).

<sup>15</sup> 17 CFR 200.30-3(a)(12).