

## FINRA Proposes Revisions to Certain NASD Rules to Provide Greater Flexibility in Maintaining Registrations of Associated Persons

On August 8, 2007, Financial Industry Regulatory Authority ("FINRA"), formerly known as the National Association of Securities Dealers, Inc. ("NASD"), filed with the Securities and Exchange Commission ("SEC") a proposal to amend NASD Rules 1021 and 1031 ("Proposed Amendment" and "NASD Rules").<sup>1</sup> The Proposed Amendment would permit FINRA member firms to maintain the registration of any person whose association with a member firm is for bona fide business purposes.

Under the current NASD Rules, FINRA member firms must register each of their associated persons, including their principals and representatives, who conduct investment banking or securities business.<sup>2</sup> As a prerequisite to registration, those persons must pass certain qualification examinations or meet an exemption from the examination requirements under the NASD Rules.<sup>3</sup> The current NASD Rules require FINRA member firms to terminate the registrations of persons no longer involved in the investment banking or securities business of the member firm, thereby prohibiting "parking" of

registrations.<sup>4</sup> The NASD Rules also require that any person whose registration has lapsed for two or more years must retake the applicable qualification examinations.<sup>5</sup> Currently, however, the NASD Rules include permissive categories of registration, allowing member firms to maintain or apply for the registration of certain persons who do not actually conduct investment banking or securities business but instead perform legal, compliance, internal audit, back-office operations, or similar responsibilities for a member, or who are engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of the member firm.<sup>6</sup>

The Proposed Amendment would remove the prohibition on the registration of persons who are not active in the member firm's investment banking or securities business or who do not fall within the permissive categories discussed above.<sup>7</sup> The Proposed Amendment would instead allow a member firm to "maintain or make application for the registration of *any person* whose association with a member is for a *bona fide business purpose of the member*, provided the person passes the appropriate qualifying examination requirements of NASD or is

<sup>1</sup> Proposed Rule Change to Amend NASD Rules 1021 and 1031 Regarding Registration Requirements, SR-FINRA-2007-004, Aug. 8, 2007 ("Proposed Amendment"), available at [http://www.finra.org/web/groups/rules\\_regs/documents/rule\\_filing/p036407.pdf](http://www.finra.org/web/groups/rules_regs/documents/rule_filing/p036407.pdf).

<sup>2</sup> See NASD Rules 1021 and 1031. Employees and other affiliates of member firms are defined as "associated persons" of the member firm under NASD Rule 1011. The NASD's rules do not distinguish between employees and independent contractors who perform the functions of associated persons.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> Proposed Amendment, at 4-5 (emphasis added).

granted an exemption from such requirements.”<sup>8</sup> The Proposed Amendment would eliminate as unnecessary the permissive categories of registration set forth in the current NASD Rules for persons who perform legal, compliance, internal audit, back-office operations, or similar responsibilities.<sup>9</sup>

In its filing with the SEC, FINRA states that the NASD qualification and registration requirements are “intended to afford reasonable assurance to the investing public that registered persons maintain and update their knowledge about products and services available to investors, as well as applicable rules, regulations and policies governing the investment banking or securities business.”<sup>10</sup> FINRA states that the NASD Rules may require member firms to terminate the registration of a person whose job function temporarily falls outside of the scope of activities that qualify for registration to avoid FINRA enforcement action.<sup>11</sup> Member firms may then face “an unnecessarily burdensome re-qualification process” to restore a person’s registration if the registration has been terminated for a period longer than two years.<sup>12</sup>

In support of the Proposed Amendment, FINRA explains that the Proposed Amendment would allow member firms “to develop a depth of associated persons with registrations in the event of unanticipated personnel changes as well as encourage[ ] greater regulatory literacy.”<sup>13</sup> FINRA further argues that, given the breadth of the NASD Rules’ permissive categories, there is no justification for disallowing the registration of persons whose job functions do not currently fall within the scope of the permissive categories, and the greater regulatory flexibility of the Proposed Amendment would better meet the business needs of member firms.<sup>14</sup>

The Investment Company Institute (“ICI”) has published and circulated to its members a proposed comment letter supporting the Proposed Amend-

ment.<sup>15</sup> In its proposed comment letter, the ICI notes that the current rules hinder “members’ ability to establish effective and efficient redundant staffing plans or to move persons between registered and unregistered positions”<sup>16</sup> and that the “added flexibility that will be provided by [the Proposed Amendment] will enable FINRA’s members to respond to those emergencies or unexpected situations requiring employees to act in registered capacities.”<sup>17</sup>

At the time of this update, the SEC had not published the Proposed Amendment for comment.

## Conclusion

Under the current NASD Rules, member firm broker-dealers face a dilemma. If a member firm fails to register a person performing specified functions, the firm and the associated person will have violated the NASD Rules. If the member firm maintains registrations for persons who no longer perform activities for which registration is permissible or required, the member firm may be guilty of “parking” licenses. Accordingly, the member firm and the associated person run risks of violating the NASD Rules both when an associated person is in a “grey area” and might or might not perform functions that require registration or when an associated person moves back and forth between functions that require registration and functions that do not.

The Proposed Amendment would permit the member firm to register its associated persons in any event, solving the dilemma that member firms face. The Proposed Amendment appears to be a positive development because the member firm and its associated persons would avoid the risk of sanctions for “parking” registrations or for being unregistered and, as FINRA notes, the registration requirements would set higher standards for such persons. Of course, after

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> Proposed Amendment, at 6.

<sup>11</sup> Proposed Amendment, at 7–8.

<sup>12</sup> Proposed Amendment, at 8.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> ICI Memorandum, Draft ICI Comment Letter Supporting FINRA Providing Greater Flexibility in Maintaining Registrations, to the ICI Transfer Agent Advisory Committee No. 54-07, Broker/Dealer Advisory Committee No. 53-07, Compliance Members No. 50-07, SEC Rules Member No. 114-01 (August 28, 2007). The ICI allowed its members to provide comments on the draft letter until September 14.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

the SEC publishes the proposal, commentators may identify additional issues.

The Proposed Amendment does not address the issue of a person who moves from a member firm to an affiliated organization, e.g., a bank. However, it appears that the Proposed Amendment is a useful first step.



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