

SECTION 1: FINRA STRUCTURE AND MEMBERSHIP PROVISIONS

1a. FINRA STRUCTURE OVERVIEW

Purposes Of FINRA

FINRA is the name for the "merged" regulator that combined the NASD's and NYSE regulatory units in 2007. It has responsibility for overseeing the equity trading markets in the United States. FINRA's purposes are to:

Promote through cooperative effort the investment banking and securities business.

Standardize business principles and practices and promote high standards of commercial honor.

Promote among members observance of Federal and State securities laws.

Promote just and equitable principles of trade for the protection of investors and to prevent fraudulent and manipulative acts.

Provide a medium through membership for conferring with governmental and other agencies in the solution of problems affecting market participants.

Promote self discipline among members and to investigate and adjust grievances between the public and members.

FINRA

FINRA enforces the following bodies of rules to which members must adhere. Note that technically, there are still some "NASD" and "NYSE" rules, since FINRA's harmonization of these rules into 1 new uniform rule set is an ongoing work in progress.

Conduct Rules

Conduct Rules: Regulations that control relations between the public (customers) and FINRA member firms. The Conduct Rules require that customers be treated "in a just and equitable manner consistent with high standards of ethical conduct." Disputes between customers and members are handled through the FINRA Code of Procedure (covered later in the chapter).

Uniform Practice Code

Uniform Practice Code: Regulations that control member-to-member relationships; for example, settlements, good delivery, etc. Disputes among

members are handled through the FINRA Code of Arbitration (covered later in this chapter).

**Disciplinary Power
Of FINRA**

In becoming a member, a firm agrees to submit itself to FINRA disciplinary actions if wrongdoing is found. The FINRA has the power to censure, suspend, expel and fine members.

1b. "MEMBERSHIP HAS ITS PRIVILEGES"

A good question to ask is "Why should I join FINRA?" The true answer lies in the fact that one cannot operate in the U.S. as a broker-dealer without being a member. Every broker-dealer that deals in non-exempt securities must be registered, as required by the Securities and Exchange Act of 1934. There used to be a method of direct registration with the SEC. This is no longer available, and so registration **must** be performed through FINRA.

**Broker-Dealers
That Need Not
Register With
FINRA**

Broker-dealers do not have to register with FINRA if their business:

Consists solely of dealing in exempt securities (e.g., Government securities dealers and Municipal securities dealers do not have to join the FINRA - they are regulated solely by the bank regulators). (Remember, the Securities Acts do not apply to transactions in exempt securities, except for fraud.);

Is performed exclusively outside the United States.

Of course, these broker-dealers can become FINRA members, if they so desire. Also note that if a firm deals in "packaged" exempt securities products, such as mutual funds, unit trusts, or CMOs where the underlying collateral consists of exempt securities, these packaged products are "non-exempt" and the firms must register with FINRA.

**Advantages Of
Membership**

The advantages of FINRA membership are:

Members are only permitted to join in domestic underwritings of non-exempt securities with other members. Non-members cannot participate. For example, a non-member bank cannot join with a broker-dealer in a common stock underwriting.

Non-members are to be given "public prices." No concessions or discounts can be granted to non-members. For example: Members can only deal with other members in stocks quoted on NASDAQ at the "inside price." The public would pay the "inside

price" **plus** an appropriate mark-up or commission as determined by the 5% Policy.

**Membership
Application**

To become a FINRA member, a membership application (Form B/D) must be filed, in which the proposed member agrees to abide by FINRA rules (e.g., Conduct Rules, Code of Procedure, Uniform Practice Code, Code of Arbitration) and to be subject to FINRA disciplinary actions. If there are any changes to the Form B/D contents, an amendment must be filed promptly.

Form B/D

**Prompt Amendment
If Changes**

**Reasons For
Denying
Membership
Application**

FINRA will reject the membership application if it finds that the broker-dealer or a person associated with that firm (known as "statutory disqualification," which is defined under the Securities Exchange Act of 1934):

**Statutory
Disqualification**

has been suspended or expelled from any other Self Regulatory Organization, either domestic or foreign (e.g., if a futures broker is expelled by the NFA - National Futures Association - that firm cannot enter the securities business by registering with FINRA);

is the subject of an SEC order suspending or revoking registration or by his conduct while associated with a firm has caused that firm's suspension or expulsion;

willfully filed a false or misleading application or has omitted to state material facts in the application;

willfully violated federal securities or commodities laws, willfully aided, abetted, counseled, commanded or procured such violations, or failed to supervise those who commit such law violations;

has been convicted of any securities or "money" related misdemeanor (such as petty larceny) or any felony (which includes DUI felonies, but not DUI misdemeanors) within the past 10 years (therefore, if you are good for 10 years and 1 day after being convicted, you can become a member again!); or

has been temporarily or permanently enjoined from engaging in the securities business.

**Eligibility
Proceeding To
Reverse Statutory
Disqualification**

Generally speaking, a person subject to statutory disqualification may not be associated with a member in any capacity. However, FINRA permits a disqualified person to request permission to enter into, or remain in, the securities industry. To do so, the member firm must file an application seeking approval of a new or continued registration in an "Eligibility Proceeding."

**If FINRA Approves
Registration In An
Eligibility
Proceeding, SEC
Must Also Approve**

The application is a package of all relevant information surrounding the disqualification. FINRA looks at the nature and gravity of the event; the length of time since the event occurred; any mitigating or aggravating circumstances; and the disciplinary history of the member firm and associated person. If FINRA approves an application, the SEC is also required to review and approve that decision; and if FINRA denies an application, an appeal may be filed with the SEC.

**Application
Information**

The membership application to FINRA includes:

a copy of the applicant's registration submission to the SEC.

trial balance and net capital computation.

member's written supervisory procedures.

list of officers, partners, and associated persons at time of application.

any other information requested by the FINRA District Office.

**Pre-Membership
Interview**

Before the applicant will be admitted, the pre-membership interview must be completed at the local FINRA District Office. (FINRA has 11 district offices, similar to those of the Federal Reserve Banks.) The interview reviews the applicant's:

level of net capital and any future capital requirements.

internal procedures and compliance procedures.

familiarity with FINRA rules.

business plan, including number, experience and qualifications of person associated with the firm;

planned facilities; clearing arrangements; and supervisory personnel.

**Determination
Within 30 Days**

Within 30 days of the interview, the District Office will notify the applicant as to whether the application is granted, denied, or granted with specified restrictions.

**Appoint Executive
Representative**

Members are required to appoint an "Executive Representative" to represent, and vote for the member in FINRA affairs. It is preferred that the "executive representative" be an executive officer or partner of the member firm.

<p>Update Contact Info. Promptly If There Are Changes</p> <p>Annual Review Of Contact Information</p> <p>FINRA Contact System</p>	<p>FINRA maintains a "Contact System" that keeps the information file on the Executive Representative. The information must be updated promptly, but no later than 30 days after any change occurs. In addition, the member firm must review, and update if necessary, the contact information within 17 business days of calendar year end.</p> <p>Note: The FINRA Contact system is used to maintain current information on each member's:</p>
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Executive Representative;

AML (Anti-Money Laundering) Compliance Person (covered in the Customer Accounts chapter);

Emergency Contact Person required under the firm's Business Continuity Plan (covered later in this chapter); and

CE (Continuing Education) Contact Person (covered later in this chapter).

For all these persons, the required updating rule is the same as that already covered for the Executive Representative.

Resignation Not Effective For 30 Days

Membership can be voluntarily terminated by a member in writing. Resignation is not effective until 30 days have elapsed from the written notice. Termination is not effective if any complaint or action is pending against the member; or if monies are owed to FINRA. Thus, the firm is still subject to FINRA jurisdiction. Furthermore, if any complaint is filed by a customer against the firm for the 2 year period following resignation, FINRA retains jurisdiction.

Resignation Not Effective If Customer Complains Within 2 Years

Cannot Transfer Registration To Another Firm

Members are prohibited from transferring their registration to another firm. The new firm must qualify on its own. However, corporate reorganizations do not require a new registration if the new company is deemed to be a successor to the old company.

1c. OBLIGATIONS OF MEMBERSHIP

Paying Of Dues

On becoming a FINRA member, the firm assumes a number of obligations. The first one listed by FINRA is the requirement for members to pay dues. FINRA assesses annual dues as follows:

Annual fee of \$75 per branch office.

Annual fee of \$150 per registered individual (this amount is reduced for firms with large numbers of registered persons);

Trading Activity Fee (TAF) for sales of registered securities (both exchange listed and OTC), securities futures and municipal securities. Note that this fee only covers secondary market transactions; underwriting fees are excluded.

Basic annual membership fee equal to the greater of;

\$1,200; or

.1215% of annual gross income for firms with up to \$25 million of gross revenue (the "GIA" - Gross Income Assessment) as reported on the firm's FOCUS report - the firm's financial filing with FINRA - covered in the next chapter. (Note that the percentage assessment drops for firms with over \$50,000,000 of gross revenue.)

In addition, starting in 2010, the "GIA" - Gross Income Assessment - is computed based on the higher of the current year's calculation or the average of the prior 3 years. This change was implemented because FINRA found itself with a 40% revenue shortfall in 2008 thanks to the implosion of the markets! It did this to smooth out its income stream).

Important note: For the exam, the fee amounts and percentages do not have to be memorized, but each item must be known.

Definition Of Gross Income

Regarding the percentages that FINRA takes of Gross Income, Total Income on a FOCUS Report includes commissions on exchange traded issues (including NASDAQ), options, all other securities commissions (e.g. OTCBB and Pink Sheet issues), gains/losses on proprietary trading, underwriting/selling group profit or loss, sales charges earned on investment company shares, and account servicing and clearing fees.

Exclusions From Income

Excluded from Total Income are commodities income (remember, commodities are not securities) and income earned outside the United States.

No Deduction For Expenses

No deductions are allowed for salaries, wages, and other operating and overhead expenses.

In addition, FINRA imposes fees for the initial membership application; for examinations; for filing any documents

with FINRA such as filings with the Committee on Corporate Financing; and for other FINRA services.

(Note: Excluded from paying these fees are exchange member firms that only deal with other members on the exchange floor - basically Specialists and floor brokers. They come under current NYSE rules that apply to floor personnel only.)

**Non-Payment Of
Dues Results In
Expulsion or
Suspension**

If a member fails to pay required dues or fees, its membership can be suspended or it can be expelled upon 15 days' written notice from FINRA.

**Proper Use
Of FINRA Name**

The next obligation of the member is to properly use the FINRA name. A member cannot state that it is endorsed by FINRA; approved by FINRA or that FINRA guarantees the member's business practices. A firm can only state that it is a "FINRA member." Furthermore, when the FINRA name is used in conjunction with the firm name, the FINRA name must be given lesser emphasis. The intent here is to insure that the firm does not represent itself as FINRA. The FINRA name can be used:

as a matter of record in trade directories.

on the firm's letterhead, market letters, sales literature as long as it is separate and given lesser emphasis.

in general advertising as long as it is used solely for identifying the firm as a member.

on the entrance way to the member's principal office or any registered branch office.

on the firm's web site, as long as the FINRA name is hyperlinked to FINRA's web site www.finra.org.

**Office Of Supervisory
Jurisdiction (OSJ)**

**OSJ Creates And
Enforces Written
Supervisory
Procedures And Has
Resident Principal**

**Branch Office
Definition**

FINRA also requires that the firm designate an Office of Supervisory Jurisdiction (OSJ), that is responsible for creating and enforcing written supervisory procedures over the branches. The OSJ must be supervised by a resident principal. Each branch office can be an OSJ; or there can be a regional OSJ supervising a number of branches; or there can simply be the main office acting as OSJ for all branches.

Regarding the branch offices, it is important to know the FINRA definition of a "branch" - since it must be registered with FINRA and must be properly supervised. A branch office is defined as a location where one or more associated persons regularly conducts securities business. In addition, if the member firm advertises the location to

customers or the public as a place where the member conducts investment banking or securities business, then it falls under the definition.

Form BR

FINRA requires that all branch locations be registered by filing a Form BR with CRD. Any changes in the information in the filing requires that an amendment be filed with CRD no later than "30 days after applicant learns of the facts and circumstances giving rise to the amendment."

Changes Require Filing Within 30 Days

Offices Excluded From Branch Definition

Back offices, primary residences of representatives, "offices of convenience," and satellite offices are not defined as branches that must be registered.

Residence Office Is Not A Branch

A registered representative's residence office would not be considered to be a "branch" as long as:

Only 1 associated person, or immediate family members, conduct business at the location;

The location is not advertised as a branch;

Customers are not met at the location;

Customer funds are not to be handled at the location;

All electronic communications and customer orders go through the firm's electronic system;

The address used on all stationary, business cards and customer communications is that of the associated person's designated branch office; and

The member keeps a list of residence locations and has written supervisory procedures for supervising sales activities at these locations.

This gives representatives the flexibility to contact customers from their residence without the location falling under the branch definition. Note, however, that if a registered representative's home office is advertised as a branch; or if customers are met or customer funds are accepted at the registered representative's home, then this location would be defined as a branch that must be registered.

Vacation Home Is A Branch If Used For 30 Or More Business Days A Year

Regarding vacation homes (any location other than a primary residence), FINRA defines these as "non-branch" locations as long as they are used for less than 30 business days a year. If they are used for 30 business days or more, they fall under the definition of a branch that must be registered and properly supervised. (As an aside, you might wonder why this rule is "business days" and not

calendar days. Well, if the rule were calendar days and a registered representative used his or her residence office to solicit or call clients on weekends, which is not uncommon, that location would be defined as a branch. Because the rule says business days, now it will not be considered a branch!)

There is no requirement for a principal to be resident in each branch office. However, FINRA, based upon the number of registered representatives located in an office, can require that there be a resident principal.

**Office Of
Convenience
Is Not A Branch**

So-called "offices of convenience" are not branches as long as they are only used occasionally and by appointment (such as meeting a customer at the local diner). Note that if the registered representative were to set up regular working hours each day at the same table in the local Starbucks, this would actually fall under the branch definition!

**Satellite Office
Is Not A Branch
If No More Than
25 Securities
Trades In A Year**

Finally, any location that is used to engage in non-securities activities (e.g., an office that sells life insurance) and that effects no more than 25 securities trades in a year is not defined as a branch. This is termed a "satellite" office.

Furthermore, any orders taken in a residence office, "office of convenience," or satellite office must still be processed through the registered branch location; and these must be under the supervision of the branch.

**Branch Location
In A Bank Setting**

Also note that FINRA has special rules for branches that are located within bank settings. There are FINRA member broker-dealers that specialize in marketing securities, usually mutual funds, by signing agreements with savings and loans. As part of the agreement, the member firm sets up a kiosk in each S & L branch, and licenses some of the employees of the S & L (such as tellers) to sell mutual funds. When the bank employee takes a bank customer into the kiosk, that bank employee magically transforms into a registered representative of the FINRA member firm, selling securities to the customer!

If a branch is located in a bank setting where deposits are being taken:

wherever possible, the physical location where the member's services are conducted should be distinct from the area where deposits are taken;

the member's name shall be clearly displayed;

at, or prior to, opening an account for the customer, the member must give (both orally and in writing) the "**Not-Not-May**" disclosure that:

the account is **Not** FDIC insured;

securities products are **Not** deposits and that they are not guaranteed by the financial institution;

securities products are subject to investment risk and **May** lose value.

Similar disclaimers are required in any communications sent to customers by the broker-dealer operating within the financial institution.

Chief Compliance Officer Who Is Series #24 Licensed

FINRA also requires that the member firm designate a Chief Compliance Officer, who, for an investment companies broker-dealer, must be a Series #24 Principal. The Chief Compliance Officer is responsible for establishing, maintaining, reviewing and testing the firm's supervisory procedures to achieve compliance with applicable FINRA rules, MSRB rules and federal securities laws and regulations.

Annual Compliance Meeting With Firm's CEO

The Chief Compliance Officer must hold at least 1 (or more) meeting(s) with the firm's Chief Executive Officer every 12 months to discuss these processes. The Chief Executive Officer (not the Chief Compliance Officer) of the member firm must sign (execute) an annual certification that is filed with FINRA.

Annual Compliance Certification Signed By CEO Filed With FINRA

The certification states that the member:

has procedures in place to achieve compliance with FINRA rules, MSRB rules and federal securities laws; modifies its procedures for relevant rule changes; and

tests the effectiveness of the procedures.

Report Reviewed By CEO

The member's processes must be evidenced in a report that must be produced prior to the attestation and the report must be reviewed by the CEO prior to the execution of the certification. In this manner, FINRA can place the blame for any compliance shortfalls not only on the Chief Compliance Officer, but also on the CEO (Chief Executive Officer) of that member firm!

1d. REGISTRATION OF PERSONNEL

Principal Registrations

Another obligation of the firm is to register "associated persons" with FINRA. FINRA requires that all principals become registered.

For "general securities broker-dealers" that trade and underwrite all types of securities, the appropriate principal license is the Series #24 General Securities Principal.

Series #24 General Principal

Every person in a general securities firm who is engaged in the:

- management of the member's business; or

- training of persons associated with the member;

must be registered as a General Principal. General Principals include:

- Sole proprietors;**

- Officers;**

- Partners;**

- Managers of Offices of Supervisory**

- Jurisdiction;**

- Directors of Corporations.**

At Least 2 Series #24 Principals In Firm

Each new membership applicant must have at least 2 principals, unless the firm is a sole proprietorship. To register as a principal, the Series #24 exam must be passed (now you know why you must endure this text). As a prerequisite to taking the Series #24 exam, the Series #7 Registered Representative exam must be completed.

Limited Principal

Limited Principal registrations are required for specialized areas. The limited principal registrations are:

General Sales Supervisor #9/10

General Sales Supervisor (#9/10): Individuals that supervise sales activities of a member with no other management functions can qualify as a limited principal. These persons cannot:

- be involved in underwriting activities;

- be involved in market making activities;

- approve advertising or sales literature;

- have responsibility for overall compliance.

Essentially, the Series #9/10 license is for persons who are branch managers. The prerequisite exam is the Series #7.

**Financial And
Operations
Principal
27**

Financial and Operations Principal (#27): Each clearing firm must have at least 1 Financial and Operations Principal. The "FinOp" is generally the firm's supervising accountant, responsible for supervising the preparation of the firm's financial reports that are filed with FINRA and the SEC. There is no prerequisite exam required.

**Limited Financial
And Operations
Principal #28**

Limited Financial and Operations Principal (#28): Each non-clearing firm must have at least 1 Limited Financial and Operations Principal. The limited "FinOp" is responsible for supervising the preparation of the firm's financial reports (which are less involved than those required for a clearing firm) with FINRA and the SEC. There is no prerequisite examination.

**Registered Options
Principal #4**

Registered Options Principal (#4): If a firm has customer accounts that will engage in options transactions, a Registered Options Principal (ROP) must approve each options account; review all options transactions; and provide general supervision over options accounts. As a prerequisite to taking the Series #4 exam, the Series #7 Registered Representative exam must be completed. In addition, the firm must have a "designated ROP" - an individual with a Series #4 license designated by name to FINRA - who is the main office compliance individual in charge of options compliance and approval of options advertising and sales literature.

**Designated ROP
Responsible For
Options Compliance**

**Investment
Companies And
Variable Annuities
Principal
26**

Limited Principal - Investment Companies and Variable Contracts (#26): To be a principal of a firm that solely engages in the sale of redeemable securities of investment companies and variable annuities (but has no other securities business), this limited principal license is available. In addition, these firms are allowed to participate in the **original** distribution of closed-end fund shares. Once these shares have been distributed, these firms **cannot** trade closed-end fund shares in the market. The prerequisite exam is the Series #6 - Investment Companies and Variable Annuities Registered Representative exam or the Series #7.

**Direct Participation
Program Principal
39**

Limited Principal - Direct Participation Programs (#39): To be a principal of a firm that solely engages in the sale of limited partnership direct participation program offerings (but has no other securities business), this limited principal license is available. The prerequisite exam is the Series #22 - Direct Participation Program Registered Representative exam or the Series #7.

Definition Of Registered Rep	FINRA requires that each representative be registered. A representative is defined as any person who solicits or conducts business in securities for the member. Persons whose duties are solely clerical or who solely handle exempted securities do not have to register. Please note that foreign associates who deal exclusively outside the U.S. do not have to be registered. Registration with FINRA is not effective until the appropriate examination is passed.
Persons Who Do Not Have To Register	
General Securities # 7	General Securities Representative (#7): Licenses an individual to sell all types of securities. FINRA has a group of "Limited Representative" licenses that allows an individual to sell a specific type of security. These Limited Representative licenses are:
Investment Companies # 6	Limited Representative - Investment Company and Variable Contracts Products (#6): Licenses an individual to sell redeemable shares of investment companies, variable contracts, and initial public offerings of closed end funds. Note that this license does not allow an individual to trade closed-end funds in the secondary market. This would require either a Series #7 or Series #62 license.
Direct Participation Programs # 2 2	Limited Representative - Direct Participation Programs (#22): Licenses an individual to purchase and sell limited partnership offerings only.
Options # 4 2	Limited Representative - Options (#42): Licenses an individual to trade call and put options only. To do so also requires a Series #62 license, which is described below.
Municipal Bonds # 5 2	Limited Representative - Municipal Bonds (#52): Licenses an individual to sell municipal bonds only.
Corporate Securities # 6 2	Limited Representative - Corporate Securities (#62): Licenses an individual to sell all corporate securities. Not covered under this license are investment companies (Series #6 license needed); direct participation programs (Series #22 license needed); options (Series #42 license needed); and municipal bonds (Series #52 license needed).
U.S. Governments # 7 2	Limited Representative-U.S. Government Securities (#72): Licenses an individual to sell U.S. Government and Agency securities only.
"Additive" Licenses	The "big" picture behind these individual limited licenses is that an individual who starts with a limited license - say Series #6 - who then wishes to sell corporate bonds, need not take the Series #7 exam. Instead, that person can take

the shorter Series #62. If the individual completes all of these limited licenses (#6; #22; #42; #52; #62, #72), then, in the eyes of FINRA, he or she has completed the full "general securities" license - that is, the equivalent of the Series #7.

Other positions requiring licensing are:

**Securities Trader
#55**

Securities Trading Representative (Series #55): Licenses an individual to be an "over-the-counter" equity trader. This license is required in addition to the Series #7 for this individual.

**Sales Assistant
#11**

Limited Representative - Assistant Representative, Order Processing (Series #11): Licenses an individual to be a sales assistant. This person is only allowed to accept **unsolicited** customer orders and can take new account information (but cannot approve or open new accounts; cannot make recommendations and cannot perform suitability determinations).

**Prohibited
Activities**

Assistant representatives are prohibited from:

- Soliciting transactions;
- Soliciting new accounts;
- Making recommendations;
- Performing suitability determinations;
- Effecting securities transactions.

**Exemption From
#11 For Limited
Activities**

If an individual **only** relays last sale price information to satisfy customer inquiries; or during high volume periods or brief absences of personnel, writes memoranda of unsolicited customer orders, that person **does not** have to be qualified by taking the Series #11 exam.

Series #11 individuals cannot be licensed with any other registered representative designation. They may only be compensated on an hourly wage or salaried basis. Compensation cannot be tied to the number or size of transactions. Bonuses are permitted, as long as they are not tied to transactions or new account openings.

**U-4 Form
Uniform Securities
Application**

To register as either representative or principal, a U-4 (Uniform Securities Application) must be completed and filed with FINRA. Registration continues with the firm unless that person leaves the firm.

**Wait Period
If Exam Is Failed**

Registration is not effective until the appropriate exam(s) are passed. If an individual fails an exam, 30 days must elapse before a new attempt is permitted. If an individual fails the same exam 3 successive times, a reattempt is not permitted until 180 days elapse. If the individual fails in any additional reattempt, another 180 days must elapse before another attempt is permitted.

**Exam Content
Is Confidential**

Also note that FINRA explicitly states that exam content is confidential. It is prohibited for any person who takes an exam to divulge the content of that exam to anyone else. FINRA can (and will) take disciplinary action against any individual that divulges exam content; any individual that uses such information when taking an exam; and their supervisors.

**Information
On U-4 Form**

Information required on the U-4 Form includes:

Applicant's Name and Address;

Broker-Dealer Name and Address;

Name and Address of "Old" Broker-Dealer if the registrant is transferring from another firm;

5 Year Consecutive Residence History;

10 Year Consecutive Employment History;

Any Other Businesses In Which The Registrant Is Currently Engaged;

Any Other Names By Which The Registrant Is Known;

Disclosure By The Applicant Of Any Arrest, Conviction, Charge, involving investments, fraud, bribery, forgery, etc.;

Disclosure By The Applicant of Any Felony Charge or Conviction; and Any Misdemeanor Charge or Conviction Involving Money, Securities, Theft, Perjury, etc. (Examples of misdemeanors that are not reported include DUIs (but felony DUIs are reported), traffic offenses, assault and battery, and failure to file income tax returns);

Disclosure By The Applicant (If Already Or Previously Registered) Of Any Customer Complaint Settled For More Than \$15,000;

Disclosure By The Applicant Of Any Customer Complaint Alleging A Sales Practice Violation Lodged Against That Individual In An Arbitration or Civil Fraud Proceeding (note that this disclosure, added in 2009, is required before the case is heard, decided, or settled).

**Changes - Prompt
Amendment**

If any of this information changes, the U-4 filing must be amended promptly.

Note that the U-4 questionnaire asks about arrests, convictions, etc., to see if the applicant will be subject to "statutory disqualification." The questionnaire asks about convictions for "any felony," which would include such things as Driving Under the Influence (DUI), possession of a controlled substance, assault, or manslaughter.

**Individuals
Convicted Of
Non-Securities
Felonies Can Be
Registered**

The SEC permits the SRO (e.g., FINRA) to approve these individuals who have such "Other Felony" convictions on a case-by-case basis. Approval is based on the proposed supervision of the person applying for registration, any subsequent disciplinary actions after the event that caused statutory disqualification and the overall merits of the case. The basic question behind the review is this: "Is this person a risk to investors?"

**Principal Verifies
Prior 3 Year's
Employment History**

For a new registration, the principal must sign and date the U-4 Form, and must verify the prior 3 year's employment history. For an amendment to a registration, the principal simply signs and dates the form. Also note that as part of the employment verification, the principal must ascertain the "good character and business reputation" of the applicant.

**Dual
Registration
Permitted If
Disclosed On
U-4 Form**

Concurrent registration with 2 or more different broker-dealers is prohibited in many states, but other states allow this. To be "dual" registered, an individual must disclose the name of each broker-dealer on the U-4 Form. Of course, that person must also obtain approval of his employer to work for the other firm.

**Outsourcing Is
Permitted, But
Cannot Outsource
Duties Of RR**

FINRA permits broker-dealers to outsource work functions to third party providers, but has stated that functions that can only be performed by registered persons cannot be outsourced to non-member firms.

More and more broker-dealer work functions require expensive computer hardware, software, and support, so a trend has developed among smaller broker-dealers to outsource these functions to a third party (one such firm is Broadridge that advertises that it provides a "menu of outsourcing solutions" for broker-dealers) that provides broker workstations, account opening and maintenance software, asset allocation and account analysis software, and back office and clearing functions (just to name a few).

**Cannot Outsource
Functions That
Require Registration**

FINRA states that if functions are outsourced, the member firm is still responsible for supervision and compliance over these functions. FINRA also states that a member cannot outsource functions that require registration, unless these are outsourced to another broker-dealer. Functions that require registration include sales

	solicitation, determining suitability, making a recommendation, and writing an order ticket.
CRD - Record Of Disciplinary Actions	Each registered person's U-4 information record is maintained on file at "CRD" - the Central Registration Depository. Any disciplinary action taken against a registered person is part of the U-4 information and is recorded in that person's file.
Cont. Education Requirements Reg. Element CE	FINRA imposes continuing education requirements ("CE") for all registered persons who deal with customers. There is a 2 part requirement:
2nd Anniversary Of Registration / Every 3 Years Thereafter	Regulatory Element: Requires that a computerized training session that reviews various regulations and procedures be completed on the registrant's 2nd anniversary of registration and every 3 years thereafter.
If Regulatory Element Is Not Completed, License Is "Inactive" Without Pay	If the Regulatory Element is not completed within the required time period (120 days of notice from CRD to the named contact person via the FINRA Contact System), that person's registration is suspended (inactive) until it is completed. During the suspension, this person cannot perform any of the functions of a registered representative and this person cannot be paid (giving him or her a very good incentive to complete the training).
Firm Element CE Annual Training	Firm Element: Requires that an annual training plan be prepared and implemented by member firms to cover relevant products, regulations, and compliance issues.
If Called For Military Duty Then Registration Becomes "Inactive" But Can Be Paid	If a registered representative is called-up or volunteers for active military duty, FINRA classifies that person as being "inactive" and their CE obligations (both Regulatory and Firm elements) are suspended. The employing broker-dealer must send a letter to CRD (the Central Registration Depository, which keeps all registration and disciplinary information on registered individuals) giving the registered representative's name and CRD number and the date the firm received notification of the call-up from the representative.
Upon Return, Registration Status Resumes At Same Point As It Was Left	Once the representative is discharged from military service, a copy of the discharge notice must be sent to CRD so that the individual can resume active registered status, basically starting from the point where he left off. FINRA has stated that it makes no difference if the individual returns to his or her "old" broker-dealer or if they associate with another broker-dealer upon return to civilian life - FINRA will reactivate that person's registration status.
Can Return To Another Broker-Dealer	

**Can Have Another
Broker At Same
Firm Service
Clients And Share
Commissions**

Also note that the firm can pay the individual while he or she is on military duty, including payments for commissions earned prior to being called-up for military service. While that individual is away in the military, he or she can arrange for another representative at the same firm to service his or her customers and can share commissions with that representative.

**Must Reassociate
Within 90 Days**

FINRA requires that individual to reassociate with a firm within 90 days of return to civilian life, otherwise registration with that member is terminated.

**FINRA Will Grant
Special Inactive
Status For 24 Months
If Individual
Leaves Employ Of
Member Firm**

Finally, FINRA has interpreted that it will grant "special inactive status" not only to currently registered individuals who are called up for active military duty, but it will also do so for anyone who is called up for active military duty in the 24 months following termination of association with a member. This keeps the person's licensing exam from lapsing and excuses the individual from the CE obligation until that individual returns from active military duty, as long as he or she reassociates with a member firm within 90 days of return from service.

**U-5 Form
Termination Of
Registration - File
Within 30 Days**

If a person is terminated, a U-5 form must be filed with FINRA within 30 days of termination. In addition, a copy of the U-5 must be supplied to the terminated individual. The person's registration is not reinstated until another firm registers that individual through a new U-4.

**If New Employer
Requests U-5 From
A New Employee -
Must Be Provided
Within 2 Business
Days**

If a person who has left a member firm associates with another member; and the new member requests a copy of that individual's U-5 form from the new employee; the new employee must provide a copy of the U-5 to the new employer within either:

2 business days of the request if the U-5 has been obtained from the ex-employer; or

2 business days of receipt from the ex-employer.

(Note: With the advent of "Web-CRD," a member firm can get the U-5 Form electronically once it is available and does not need to obtain it from the representative. However, this "old" rule is still on the books and still can be tested.)

**Bank Employee
Registered Through
A Broker/Dealer**

A different issue arises regarding member branches in bank settings. What is common here is that bank employees become registered personnel of a broker-dealer who has signed a marketing agreement with the bank.

**Termination
Requires Prompt
Notice To Bank**

Even though the employees are paid by the bank, they are registered through the separate broker-dealer. FINRA requires that if a member terminates registration of such

an individual for cause, that in addition to the U-5 filing, the member firm must promptly notify the bank of the termination.

**Amend The U-5
Filing Within 30
Days Of Discovery
For Subsequently
Discovered
Information**

If information becomes known about the individual that was not included on the U-5 filing (such as, the member firm discovers 8 months after an individual was terminated, that he or she was doing a little embezzling), the member must amend the U-5 filing within 30 days. This obligation to amend U-5 filings for subsequently discovered information is an ongoing obligation that has no cut-off date.

**After 2 Years, Must
Requalify By Exam**

After 2 years without being associated with a firm, that person must requalify by taking the appropriate exam(s).

**"Hanging" Licenses
Is Prohibited**

FINRA explicitly prohibits an individual from "hanging" his or her license with a broker-dealer to keep registration current (and therefore not having to retake exams) after leaving the business.

**FINRA Retains
Jurisdiction For 2
Years If Terminated**

Once a person is terminated, if a customer complaint is filed, FINRA retains jurisdiction over that person for 2 years. Also, please note that FINRA does not permit termination of registration via a U-5 if there is any complaint or action being taken against that person. Only **after** the issue is resolved does the U-5 take effect, and the 2 year period starts counting.

**"Reportable
Events"**

FINRA requires that the member firm file a written report if it appears that the firm itself, or an associated person, has gotten into trouble. Note that these reports are required as the event is happening - even if there is no proof or conviction. FINRA assesses the severity of the information in the report in order to decide whether it needs to take further action.

**Notify FINRA
Promptly But
No Later Than 30
Days After Event**

FINRA requires that it be notified in writing promptly, but no later than 30 calendar days, after the member firm knows or should have known, if the firm itself or any registered employee is:

found to have violated any provision of any securities law;

subject of a written customer complaint alleging theft, misappropriation of funds, or forgery;

named as a defendant or respondent in any legal proceeding alleging violations of the Securities Acts brought by a regulatory authority;

denied registration or is expelled, suspended, or disciplined by any self regulatory organization;

indicted, convicted, or pleads guilty to any criminal offense (except for misdemeanor traffic violations and misdemeanor DUIs);

associated with any broker-dealer, investment company, investment advisor, or insurance company which was suspended, expelled or had its registration denied; or which was convicted of, or pleaded no contest, to any felony or misdemeanor;

a defendant or respondent in any securities or commodities related civil litigation or arbitration settled for an amount exceeding \$15,000 (this limit is raised to \$25,000 if the settlement involved that member firm itself);

subject to statutory disqualification, as listed on page 3 of this section;

the subject of disciplinary actions by their firm involving suspension, termination, withholding of commissions, or imposition of fines in excess of \$2,500.

In addition, the rule requires that each member firm report to FINRA under the same time frame if the member firm has concluded that an associated person, or the firm itself, has violated any securities-, insurance-, commodities-, financial- or investment-related law - either domestic or foreign.

**Quarterly Filing Of
Summarized
Customer Complaint
Information**

Regarding written customer complaints, FINRA requires each member firm to file statistical and summary information quarterly - on the 15th of the month following the calendar quarter in which the complaint was received.

**FINRA BrokerCheck
Website**

FINRA maintains a website called "BrokerCheck" where the general public can get information on a broker or member firm. The website uses the U-4 and U-5 information to give the broker's:

**Broker's Employment
History**

10-year employment history, both in and outside the securities industry, taken from the U-4 Form;

Broker's Licenses

securities licenses and state registration(s);

**Broker's Complaint
And Disciplinary
Record**

disciplinary record, which includes both complaints and allegations that have not yet been resolved; as well as a record of any disciplinary or settlement actions taken.

Regarding the fact that unresolved customer complaints and allegations are included, FINRA used to exclude this

information, but took "heat" for this, so it is now included. They, do, however, include a disclaimer that this information does not automatically indicate wrongdoing!

Specifically excluded from the BrokerCheck record, due to privacy concerns, is the U-4 information on residence history, social security number and physical characteristics, such as a representative's height, weight, hair color and eye color. (This is the information that is used by law enforcement to find a registered person they wish to arrest, and it could be used by a public customer that wishes to stalk or harm a registered representative.)

BrokerCheck includes information on both representatives that are currently working in the securities industry and representatives that have left the business. It allows the public to get a profile of each member firm, with its disciplinary record. This file also includes previously registered member firms that have shut their doors.

Finally, if a customer does not have web access, the BrokerCheck information is available from a FINRA toll-free phone number.

BrokerCheck Notice To Customer

When a customer account is opened, FINRA Rule 2280 requires that the customer be provided with the:

BrokerCheck toll-free number;

BrokerCheck mailing address; and the

FINRA website address.

In addition, the customer must be given notice of an available BrokerCheck brochure. There is no disclosure of a FINRA "800" number required. A logical question is: "Why no disclosure of the BrokerCheck website address?" The answer is the FINRA does not own it! It was grabbed by someone else and, probably, FINRA does not want to pay an extortionate amount of money for it. The only way to get to the real BrokerCheck is through the FINRA website, which is why their web address must be given.

1e. BUSINESS CONTINUITY PLAN

Procedures To Be Followed If There Is A Business Disruption

FINRA requires that each member firm create and maintain a business continuity plan that identifies the procedures to be followed if there is an emergency or significant business disruption so that the member can meet its existing obligations to customers. In addition, the plan must include procedures covering existing relationships with other broker-dealers.

**Copy Of Plan
Kept Off-Site**

There is no requirement to file the plan with FINRA, but it must be made available promptly upon request of FINRA. A copy of the plan must be maintained at a secure, off-site facility. FINRA has contracted with EVault as the back-up repository for firms that do not have their own back-up facility.

Update For Changes

If there is a material change in the member firm's operations, structure, business or location, the plan must be updated. In addition, an annual review of the plan by the Series #24 Principal is required to determine if modifications are needed.

**Annual Plan Review
By Series #24**

**Plan Elements
Are Flexible**

The FINRA rule states that the elements of the plan are "flexible" and the plan may be tailored to the needs and size of the member firm.

Minimum Elements

However, the plan must cover, at a minimum:

Data back-up and recovery;

Mission critical systems;

Financial and operational assessments;

Alternate communications between member and customers; and member and employees;

Alternate physical location of employees;

Critical business, bank and counter-party impact;

Regulatory reporting and communications with regulators; and

How the member will assure customers prompt access to their funds in the event that the member ceases business.

Note that for members that introduce their accounts into a clearing firm, many of these functions are performed by the clearing firm. FINRA states that in this case, the plan must still create specific procedures to be followed in the event of significant business disruption, and the plan can use information contained within the clearing firm's continuity plan for this purpose.

The plan must be approved by a Series #24 Principal and the required annual review must be conducted or supervised by the Series #24 Principal.

**Disclose Details
Of Business
Continuity Plan
To Customers At
Account Opening**

At account opening for a customer, the member must disclose, in writing, how the member's business continuity plan addresses the possibility of significant business disruption and how the member plans to respond to events of varying scope by giving detailed scenarios.

**Web Site Disclosure;
Mail To Customers**

In addition, this disclosure must be posted on the member firm's Web site and must be mailed to customers on request.

**2 Designated #24
Emergency Contact
Persons**

Under a related rule, FINRA requires each member firm to designate two emergency contact persons to FINRA that are registered principals and members of the firm's senior management.

If the firm is a sole proprietorship, then the second contact person should be another firm employee or, for a firm with only 1 employee, the second person may be an individual with knowledge of the member's business operations, such as the member's accountant, attorney or clearing firm. FINRA requires that this information be filed electronically through the FINRA Contact System, and that it be updated promptly in the event of a material change.

**Prompt Update
For Changes In
Emergency Contact
Information**

To insure the information's accuracy, the member must promptly update the information for changes, but no later than 30 days after the change.

**Annual Review Of
Contact Information**

In addition, the member must review and update this information as needed within 17 business days after the end of each year. This review (and update, if needed) must be conducted by the member firm's Executive Representative, or his or her written designee.