

Supervision of Brokerage Office Personnel and Procedures

INTRODUCTION

Guidelines for the practices that a brokerage firm uses to conduct the operation of its daily business are regulated by industry, state, and federal regulators. These guidelines are the foundation for the way that the firm handles all business, from hiring a new agent to executing a customer's order. All Series 10 candidates must have a full understanding of a brokerage firm's operations and procedures to successfully complete the exam.

HIRING NEW EMPLOYEES

A registered principal of a firm will be the individual who interviews and screens potential new employees. The principal will be required to make a thorough investigation into the candidate's professional and personal backgrounds. With few exceptions, other than clerical personnel, all new employees will be required to become registered as an associated person with the firm. Additionally, all employees of the broker dealer who are involved in securities sales, have access to cash and securities, or who supervise employees must be fingerprinted. The new employee will begin their registration process by filling

out and submitting a Uniform Application for Securities Industry Registration, also known as Form U4. The Form U4 is used to collect the applicant's personal and professional history, including the applicant's:

- 10-year employment history.
- Five-year resident history.
- Legal name and any aliases used.
- Any legal or regulatory actions.

The principal of the firm is required to verify the employment information for the last three years and must attest to the character of the applicant by signing Form U4 prior to its submission to FINRA. All U4 forms will be sent to the Central Registration Depository (CRD) for processing and recording. Any applicants who have answered yes to any of the questions on the form regarding their background must give a detailed explanation in the Disclosure Reporting Pages (DRPs) attached to the form.

The applicant is not required to provide information regarding his or her:

- Marital status.
- Educational background.
- Income or net worth.

The only information regarding the employee's finances that is disclosed on Form U4 is whether the associated person has ever declared bankruptcy. Any development that would cause an answer on the associated person's U4 to change requires that the member update the U4 within 30 days of when the member becomes informed of the event. In the case of an event that could cause the individual to become statutorily disqualified, such as a felony conviction or misdemeanor involving cash or securities, the member must update the associated person's U4 within 10 business days of learning of the event.

RESIGNATION OF A REGISTERED REPRESENTATIVE

If a registered representative voluntarily resigns or has his or her association with a member firm terminated for any reason, the member must fill out and submit a Uniform Termination Notice for Securities Industry Registration, known as Form U5. The member must submit the U5 to FINRA within

30 days of the termination. The member firm is also required to give a copy of the U5 to the representative upon termination. The member must also state the reason for the termination, either voluntary or for cause. An associated person's registration is nontransferable. A representative may not simply move the registration from one firm to another. The employing firm that the representative is leaving must fill out and submit a U5 to FINRA, which terminates the representative's registration. The new employing firm must fill out and submit a new U4 to begin a new registration for the associated person with the new employer. The new employer is required to obtain a copy of the U5 form filed by the old employing member either from the employee or directly from FINRA within 60 days of submitting the new U4. The previous employer is not required to provide a copy to the new member firm. If the new employing member asks the associated person for a copy of the U5, the person has two business days to provide it. If the member requests a copy of the U5 from an agent who has not received a copy of the U5 from the old employer, the agent must promptly request it from his or her old employer and provide it to the new employer within two business days of receipt. A representative who leaves the industry for more than 24 months is required to requalify by exam. During a period of absence from the industry of two years or less, FINRA retains jurisdiction over the representative in cases involving customer complaints and violations.

**TAKENOTE!**

A firm may not allow an inactive agent to "park" his or her license with the firm and may not maintain an inactive agent's license on the books simply to ensure that the agent does not have to requalify by exam. The one exception to the rule is for agents in the military who are called to active duty. While on active duty, the agent's registration will be "tolled" until the agent returns.

REGISTRATION EXEMPTIONS

The following individuals are exempt from registration:

- Clerical personnel.
- Nonsupervising officers and managers not dealing with customers.

- Non-U.S. citizens working abroad.
- Floor personnel.

Nonregistered personnel may:

- Offer to send literature to prospective customers.
- Invite current or prospective customers to attend firm-sponsored events.
- Invite prospective customers to speak with a registered representative.
- Discuss account information with existing customers.

Nonregistered personnel may not:

- Receive compensation other than salary or hourly wage.
- Solicit orders or new accounts.
- Discuss investment products or services offered by the firm.
- Qualify prospective customers by discussing the individual's financial information.

All NYSE member firms that allow nonregistered personnel to have contact with existing or potential customers must train the personnel as to the limits on what may be discussed with existing or potential customers.

RETIRING REPRESENTATIVES/ CONTINUING COMMISSIONS

A retiring representative may continue to receive commission on the business that he or she has built over a career if a contract is in place before the representative's retirement. A retiring representative may continue to receive commissions on old business only and may not receive commissions on any new business and may not receive finder's fees. If the retired representative dies, the representative's beneficiary may continue to receive the commissions that were due the representative.

PERSONS INELIGIBLE TO REGISTER

Individuals applying for registration must meet the association's requirements in the following areas:

- Training.
- Competence.

- Experience.
- Character.

Anyone who fails to meet the association's or exchange's requirements in any of the above listed areas may not become registered. An individual may also be disqualified by statute or through rules for any of the following:

- Expulsion, suspension, or disciplinary actions by the Securities and Exchange Commission (SEC) or any foreign or domestic SRO.
- The individual caused the expulsion or suspension of a broker dealer or principal.
- The individual made false or misleading statements on the application for registration on Form U4 or Form BD.
- Felony conviction or misdemeanor involving securities, bribery, falsification of reports, perjury, or any other felony within the last 10 years.
- Court injunction or order barring the individual.

DISCIPLINARY ACTIONS AGAINST A REGISTERED REPRESENTATIVE

If another industry regulator takes disciplinary action against a representative, the employing member firm must notify FINRA. Actions by any of the following should be immediately disclosed to the association:

- The SEC.
- An exchange or association.
- A state regulator.
- A clearing firm
- A commodity regulatory body.

All disclosures must include the type of action brought as well as the name of the party bringing the actions and the name of the representative involved. FINRA members are required to regulate the activities of its associated people and must disclose to the association any action that the member takes against a registered representative.

TERMINATION FOR CAUSE

A member may terminate a registered representative for cause if the representative has:

- Violated firm policy.
- Violated the rules of FINRA, the SEC, or any other industry regulator.
- Violated state or federal securities laws.

A firm may not terminate a representative who is the subject of investigation by any securities industry regulator until the investigation is completed.

OUTSIDE EMPLOYMENT

If a registered representative wants to obtain employment outside of his or her position with a member firm, the registered representative must first provide written notification to the employing member firm. The member firm may reject or limit the representative's outside employment. Exceptions to this rule are if the registered representative is a passive investor in a business or if the representative owns rental property. All other outside business activities must be disclosed to the member firm. If the member is a NYSE member, it must provide the representative with prior written approval before the representative engages in any outside activity.

PRIVATE SECURITIES TRANSACTIONS

A registered representative may not engage in any private securities transactions without first obtaining the broker dealer's prior written approval. The registered representative must provide the employing firm with all documentation regarding the investment and the proposed transaction. An example of a private securities transaction would be if a representative helped a startup business raise money through a private placement. If the representative is going to receive compensation, the employing member firm must supervise the transaction as if the firm itself executed the transaction. If a representative sells investment products that the employing member does not conduct business in without the member's knowledge, then the representative has committed a violation known as selling away. An exception to this is if the

representative is helping an immediate family member to raise money and the representative receives no compensation for his or her role in the private transaction. In this case, the notification and permission of the member is not required.

GIFT RULE

Broker dealers may not pay compensation to employees of other broker dealers. If a broker dealer wants to give a gift to an employee of another broker dealer, it must:

- Be valued at less than \$100 per person per year.
- Be given directly to the employing member firm for distribution to the employee.
- Have the employing member's prior approval for the gift.

The employing member must obtain a record of the gift, including the name of the giver, the name of the recipient, and the nature of the gift. These rules have been established to ensure that broker dealers do not try to influence the employees of other broker dealers. An exception to this rule would be in cases where an employee of one broker dealer performs services for another broker dealer under an employment contract. The following are also excluded from the \$100 limit:

- Occasional meals.
- Occasional tickets to sporting events.
- Business-related travel.

Records of gifts and employment contracts must be retained for three years. Prior FINRA approval is not required for employment contracts between members. The gift rule also applies to gifts given to or received from customers of the firm or agent. In the case of a mutual fund holding a seminar, the mutual fund may pay for registered representative's travel-related expenses and the seminar must be held at a "reasonable" location. Spouses of agents are allowed to attend; however, the mutual fund may only pay for the travel expenses of the agent. The agent's expenses may not be paid for by the fund in exchange for past sales or the promise of sales in the future.

 **TAKENOTE!**

Firms and agents also may not give a gift to influence any report or dissemination of information designed to influence the price of a security.

COMMUNICATIONS WITH THE PUBLIC

Member firms will seek to increase their business and exposure through the use of both retail and institutional communications. Strict regulations are in place in order to ensure that all communications with the public adhere to industry guidelines. Some communications with the public are available to a general audience and include:

- Television/radio
- Publicly accessible websites
- Motion pictures
- Newspapers/magazine
- Telephone directory listings
- Signs/billboards
- Computer/Internet postings
- Video displays
- Other public media
- Recorded telemarketing messages

Other types of communications are offered to a targeted audience. These communications include:

- Market reports
- Password-protected websites
- Telemarketing scripts
- Form letters or e-mails (sent to more than 25 people)
- Circulars
- Research reports
- Printed materials for seminars

- Option worksheets
- Performance reports
- Prepared scripts for TV or radio
- Reprints of ads or sales literature

FINRA RULE 2210 COMMUNICATIONS WITH THE PUBLIC

FINRA Rule 2210 replaces the advertising and sales literature rules previously used to regulate member communications with the public. FINRA Rule 2210 streamlines member communication rules and reduces the number of communication categories from six to three. The three categories of member communication are:

- Retail communication
- Institutional communication
- Correspondence

RETAIL COMMUNICATION

Retail communication is defined as any written communication distributed or made available to 25 or more retail investors in a 30-day period. The communication may be distributed in hard copy or in electronic formats. The definition of a *retail investor* is any investor who does not meet the definition of an institutional investor. Retail communications now contain all components of advertising and sales literature. All retail communications must be approved by a registered principal prior to first use. The publication of a post in a chat room or other online forum will not require the prior approval of a principal so long as such post does not promote the business of the member firm and does not provide investment advice. Additionally, generic advertising will also be exempt from the prior approval requirements. All retail communication must be maintained by the member for three years. If the member firm is a new member firm that has been in existence for less than 12 months based on the firm's approval date in the Central Registration Depository (CRD), the member must file all retail communications with FINRA 10 days prior to its first use unless the communication has been previously filed and contains no material changes or has been filed by another member, such as an investment company or ETF sponsor. Member firms that have been established for more than 12 months may file retail communications with FINRA 10 days after the

communication is first used. Retail communications regarding Investment companies, ETF sponsors, and variable annuities must be filed 10 days prior to first use. Should FINRA determine that a member firm is making false or misleading statements in its retail communications with the public, FINRA may require the member to file all of its retail communication with the public with the association 10 days prior to its first use.

INSTITUTIONAL COMMUNICATIONS

Institutional communication is defined as any written communication distributed or made available exclusively to institutional investors. The communication may be distributed in hard copy or in electronic formats. Institutional communications do not have to be approved by a principal prior to first use so long as the member has established policies and procedures regarding the use of institutional communications and has trained its employees on the proper use of institutional communication. Institutional communication is also exempt from FINRA's filing requirement, but like retail communications it must be maintained by a member for three years. If the member believes that the institutional communication or any part thereof may be seen by even a single retail investor, the communication must be handled as all other retail communication and is subject to the approval and filing requirements as if it was retail communication. An institutional investor is a person or firm that trades securities for his or her own account or for the accounts of others. Institutional investors are generally limited to large financial companies. Because of their size and sophistication, fewer protective laws cover institutional investors. It is important to note that there is no minimum size for an institutional account. Institutional investors include:

- Broker dealers.
- Investment advisers.
- Investment companies.
- Insurance companies.
- Banks.
- Trusts.
- Savings and loans.
- Government agencies.
- Employment benefit plans with more than 100 participants.
- Any non-natural person with more than \$50,000,000 in assets.