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FINRA Proposes New Registration And Examination Rules

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

On March 8, 2017, the Financial Industry Regulatory Authority (FINRA) filed a proposed rule change with the SEC to adopt amended registration rules and restructure the entry-level qualification examination for registered representatives. The new rules would also eliminate certain examination categories. FINRA is planning to implement the changes in two phases, with full implementation completed during the first half of 2017.

Securities Industry Essentials Exam

As part of the proposed amendments, FINRA introduced a new beginning-level examination called the Security Industry Essentials (SIE), which can be taken by individuals without sponsorship by a broker-dealer. The SIE would be a general-knowledge examination including fundamentals such as basic product knowledge, structure and functioning of the securities industry markets, regulatory agencies and their functions, and regulated and prohibited practices.

Under the proposed new rules, anyone desiring to work in the securities industry for a member firm would need to take the SIE. The SIE would also be open to anyone who desires to take it. When becoming employed by a member firm, a person would then need to take an additional exam associated with their particular job function (for example, series 7, 79 or 24). The new SIE exam would not change the requirement to pass tests associated with those additional licenses, or that such licenses expire if a person is not associated with a member firm for a two-year period. However, as discussed below, the proposed new rules add the ability to extend this two-year period in certain instances.

Currently, in order to qualify to take a registered representative examination to become licensed in the securities industry, a person must be employed and sponsored by a FINRA member broker-dealer. The intent of the SIE is to prequalify potential job applicants, saving member firms time and expense on vetting registered representatives and putting them through the examination process. A member firm will be able to view the SIE passing status and score on FINRA's CRD system.

The proposed SIE is broken down into four categories: (i) "Knowledge of Capital Markets," which focuses on topics such as types of markets and offerings, broker-dealers and depositories, and economic cycles; (ii) "Understanding Products and Their Risks," which covers securities products at a high level as well as associated investment risks; (iii) "Understanding Trading, Customer Accounts and Prohibited Activities," which focuses on accounts, orders, settlement and prohibited activities; and (iv) "Overview of the Regulatory Framework," which encompasses topics such as SRO's, registration requirements and specified conduct rules.

Individuals that have passed the SIE but not yet taken a specialized knowledge examination, would not be subject to continuing education requirements.

Individuals that are already licensed as of the effective date of the new SIE, will not need to take the exam and will be deemed to have passed such exam. The SIE qualification will remain valid for four years without the person being registered with a firm. However, other licenses, such as a Series 7, may lapse if a person is not associated with a member firm for a two-year period.

Although not discussed by FINRA, I see an opportunity to use the SIE for multiple purposes going forward as the securities laws and regulations continue to evolve. In particular, the SIE could be a factor in considering whether a person is accredited. The SIE could also be a factor in considering exemptions from the registration requirements for finders, a topic that continues to be at the forefront for regulators and practitioners alike. I will be writing about the subject of finders again very soon. In my view this is a topic that needs immediate attention. The fact is that regulators do not have the resources to police the finders industry, which has indeed become a full industry. Thousands of people operate as unlicensed finders, and their use has become accepted and commonplace in the small- and micro-cap industries. Clearly, the simple “it is not allowed” approach of regulators is not working. Unfortunately, without some parameters and workable regulation around this function, bad actors, inexperienced and completely unknowledgeable individuals hold themselves out as finders together with those that can abide by basic disclosure and antifraud provisions in the offer and sale of securities. Perhaps the SIE or a variation thereof could be used as part of a workable regulatory regime related to finders.

Extension of Time Prior to License Termination

Currently, if a registered person is not employed with a member firm for a period of two years, their securities license will lapse (except for the SIE) and they will need to retake a particular examination if they become re-employed by a member firm. The new rules allow this two-year period to be extended for up to seven years where a person is working for a non-FINRA member financial services affiliate.

That is, a person can maintain licensing for up to seven years while working for a non-FINRA member financial services affiliate of the member firm (such as a parent company) if the following conditions are met: (i) the person has been registered with a FINRA member for a total of five out of the past ten years, the most recent of which must be their current employer; (ii) when the person transitions to the affiliate, a Form U-5 must be filed notifying FINRA of the transition; (iii) the person must continue to satisfy continuing education requirements and have no pending or adverse regulatory matters; and (iv) the person must continuously work for the financial services affiliate.

If each of these qualifications is met, the person can re-register with a member firm for up to seven years without retaking a licensing examination.

Consolidated Examination Structure; Elimination of Exam Levels

Over time, the number of exams and licensing levels has expanded such that as of today, there are 16 exams with a considerable amount of content overlap and requirements for individuals to pass multiple exams to work in a given job function. There are 11 FINRA exams alone for a registered representative engaging in sales activities with investors, most of which focus on specific products, such as options or private securities.

The proposed consolidation and simplification of the examination process is the result of an effort to reduce redundancies and simplify the process, resulting in cost savings for all parties including FINRA, the member firm and representatives, and eliminating outdated examinations and materials.

A part of the consolidation and simplification is the introduction of the SIE discussed above, which will test on general securities knowledge, eliminating that portion of testing for specific specialized functions and duties of the registered representative. Under the proposed rules, a person would need to take the SIE as a precondition to taking a specialized knowledge examination. The SIE remains valid for a four-year period. Moreover, although a person is not required to be associated with a member firm to take the SIE, they will be required to be associated with and sponsored by a member firm to take the specialized knowledge exam.

The new specialized knowledge exams would eliminate questions on basic industry knowledge covered in the SIE. In addition, FINRA is proposing to reduce the current 16 exams to new exams covering: (i) investment company and variable contracts products representative (current Series 6); (ii) general securities representative (current Series 7); (iii) direct participation programs representative (current Series 22); (iv) equity trader (current Series 55); (v) investment banking representative (current Series 79); (vi) private securities offerings representative (current Series 82); (vii) research analyst (current Series 86 and 87); and (viii) operations professional (current Series 99).

In addition to consolidating certain exam levels, FINRA is proposing to eliminate the following exams: (i) option representative (Series 42); (ii) corporate securities representative and government securities representative and associated exams (Series 62 and 72); and (iii) order processing assistant (Series 11). FINRA is also considering eliminating the Series 17, 37 and 38, which deal with representatives who conduct cross-border foreign business with the U.K. and Canada.

Registration Amendments

Under current rules, FINRA limits individuals that can obtain a securities license, to those working in certain functions. Currently a person must be actively engaged in the securities or investment banking business of a firm in order to be licensed, subject to certain exceptions. Those exceptions include, for example, persons performing legal, compliance, internal-audit, back-office or similar functions and persons performing administrative functions for registered persons.

The new rules would eliminate the restrictions on these permissive registrations, and allow any employee of a member firm to take examinations and be licensed in any capacity which that firm's membership with FINRA encompasses. For example, a person not actively engaged in investment banking could nevertheless take the Series 79, or a person not actively engaged in retail client management could take the Series 7. The new rules add supervisory responsibilities for the member firm related to persons holding licenses in areas for which they are not actively engaged.

Among other benefits, the intent of the new rules is to simplify the registration requirements and encourage individuals to cross-train within a member firm's organization.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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