

Morgan Lewis



WHO COUNTS? RETHINKING “ASSOCIATED PERSON” STATUS UNDER FINRA AND THE SEC

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Agenda

- **Case Studies**

- Practical examples to instigate discussion and level-set on existing conceptions and market practice

- **Key Concepts**

- What does the law say?

- **Enforcement Landscape**

- Is there still interest in this space?

- **Compliance Strategies**

- Considerations for advising the business and moving forward

Case Study #1 – IT Developers

Acme Securities, a broker-dealer, has experienced challenges in connection with its Electronic Blue Sheet productions. To address the issues, Acme has engaged an unaffiliated IT Vendor to develop a custom software product to facilitate the firm providing complete, accurate, and timely Blue Sheet data in response to regulatory requests. Once the product is developed by the Vendor away from Acme, Acme's internal IT team is responsible for testing and ultimately deploying the software on Acme's systems.

- Are the Vendor's technologists APs?
- What if the Vendor is an affiliate of Acme?

Case Study #2 – Shared Services

Acme Holdings has a shared services model for its operating companies, which covers various functional areas, including HR. Personnel in shared services, as well as Acme Securities' financial advisors, are employed by Acme Operations.

HR supports Acme Bank, Acme Insurance, and Acme Securities. Certain individuals will be dedicated to a business other than Acme Securities (e.g., Acme Bank), while others will be dedicated to or allocate at least part of their time to Acme Securities. Those who support Acme Securities are involved in, among other things, facilitating interviews and exit-interviews, administering the employment application and background review processes, and assisting in the proper completion, submission, and retention of Forms U4.

- Are the HR personnel supporting Acme Securities APs?
- Does it matter if they only spend part of their days on Acme Securities?
- What if their role is solely clerical and ministerial, and Acme Securities APs are responsible for confirming applications, Forms U4, etc. are in good order and recorded?

Case Study #3 – Back-Office Support

Acme Securities has engaged an unaffiliated Vendor in Mumbai to provide back-office operations support services. The Vendor provides these services to numerous financial services firms in the United States. Activities include supporting post-trade processing (e.g., allocation processing, confirmation/statement support), cash and position journaling, corporate actions processing, and preparation of data for FOCUS computations. The Vendor does not interact directly with Acme Securities financial advisors or clients, and the activities do not require OSJ or branch registration. Certain personnel employed by the Vendor are responsible for (i) approving general ledger journal entries, (ii) supervising financial functions, such as disbursement of funds, settlement, buy-ins and fails, and possession or control, and (iii) approving business requirements of systems that support “covered functions”?

- Are these Vendor personnel APs?
- What if the Vendor is an affiliate of Acme?
- What if the Vendor is based in the United States?

Case Study #4 – Back-Office Support

Same facts as Case Study #3, but the engagement has been structured so that the Vendor's personnel generally engage only in preparatory, not final, actions, and the Vendor's personnel do not create or have any ability to impact the firm's original books and records (aside from those individuals described in Case Study #3). Acme Securities APs (whether registered or not) review and cause the final action to occur (i.e., APs "push the final button").

- Are these Vendor personnel who engage only in preparatory actions APs?
- Are they APs if they are supervised directly by an AP (e.g., an Ops Professional)?

Associated Persons: Overview

- **Any individual** who **performs services for a broker-dealer** may be deemed to be an Associated Person of the broker-dealer
 - Regardless of whether the broker-dealer is that person's legal employer (e.g., independent contractors, consultants, or others providing services to a broker-dealer)
 - Regardless of domicile or jurisdiction
- **Various standards** can apply depending on the context, including under the Exchange Act, FINRA and other SRO rules, and even certain States
- **Key consequences**
 - Statutory disqualification; fingerprinting; supervision

You Are an Associated Persons If You:

Are a partner, officer, director, or branch manager of, or employed by, the broker-dealer

Are registered or applying to be registered (including permissive registrants)

Have regular access to the keeping, handling, or processing of (1) securities, (2) monies, or (3) the original books and records*

Are responsible for (1) approving general ledger journal entries, (2) supervising financial functions, such as disbursement of funds, settlement, buy-ins and fails, and possession or control, and/or (3) approving business requirements of trading systems related to “covered functions”**

Approve, modify, or implement technology systems that support the investment banking or securities business (e.g., trading, finance and accounting, back-office operations), without intervention and adoption of such systems by the broker-dealer

You *Might Be* an Associated Person If:

You have access to confidential, proprietary information of the broker-dealer, including MNPI and/or nonpublic personal information of the broker-dealer's customers

Your role goes beyond being engaged in enterprise-wide functions and results in being engaged in specific activities related to the broker-dealer's investment banking or securities business, and such activities are subject to the control of the broker-dealer

Regarding intercompany shared services (e.g., HR, benefits, IT, communications, real estate/facilities, legal), the broker-dealer controls or manages your day-to-day activities

Your role goes beyond being engaged in the "business of doing business"

Fingerprinting (& Exemptions)

- Section 17(f)(2) requires broker-dealers to fingerprint their partners, directors, officers, and “employees,” **unless** exempt
 - Includes independent contractors and others who qualify as Associated Persons
- **Rule 17f-2** exempts employees from fingerprinting who **do not**:
 - Sell securities;
 - Regularly have access to the keeping, handling, or processing of securities, monies, or the original books and records relating to the securities or monies; **and**
 - Have direct supervisory responsibility over those who sell securities or have access to securities, monies, or the original books/records.
- “Notice Pursuant to Rule 17f-2” required
- No exemption from the fingerprinting requirement for non-U.S. personnel
 - Except pursuant to an exemptive order

Enforcement Precedent

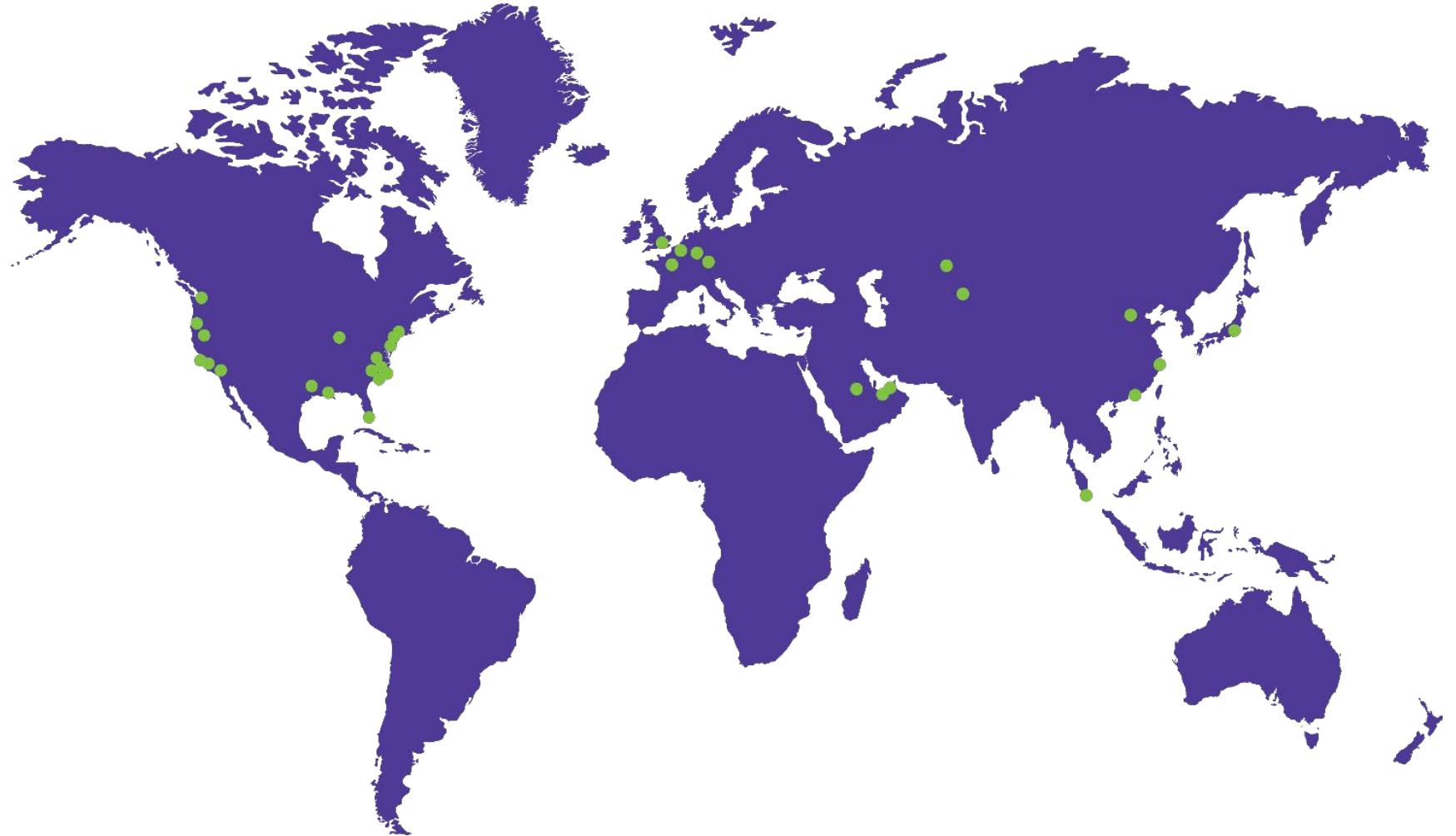
- FINRA has settled several matters concerning fingerprinting and background checks. Key takeaways:
 - All Associated Persons must be screened for statutory disqualifications
 - Most Associated Persons must be fingerprinted (including anyone with regular access to the keeping and handling of monies, securities, and original books and records), including non-U.S.-based Associated Persons
 - Affiliate employees who perform work for a broker-dealer may be Associated Persons and thus subject to screening and fingerprinting
 - Persons who transfer to a broker-dealer from an affiliate (including a FINRA member firm) must be subject to new screening and fingerprinting at the time of transfer
 - Firms must follow their own procedures and be able to document compliance with any claimed exemptions

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