

Broker-Dealer Beat: FINRA Updates Background Investigation Rule

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New FINRA Rule 3110(e) streamlines and clarifies members' obligations relating to background investigations of registered persons and adds a requirement to adopt written procedures to verify the accuracy and completeness of the information in an applicant's Form U4, including the requirement to conduct a public records search. The new rule, which replaces NASD Rule 3010(e), becomes effective on July 1, 2015.

Under the new rule, members must investigate the good character, business reputation, qualifications and experience of an applicant *before* applying to register that applicant. Firms must also establish and implement written procedures for completing the Form U4 verification process, including a national public records search, no later than 30 days after filing an initial or transfer Form U4. The investigation and verification requirements are intended to be complementary, not duplicative, although FINRA expects many firms will conduct both processes concurrently using some of the same information before filing the Form U4. In fact, FINRA encourages completion of the verification process before filing the Form U4. Firms will incur a Late Disclosure Fee if a disclosure event should have been reported on the initial or transfer Form U4, regardless of whether the verification process is completed within the 30 day window. In instances where the verification process cannot be timely completed (e.g., fingerprints are illegible and must be resubmitted), the procedures should provide for completion of the verification process as soon as possible with documentation for the basis for the delay.

To satisfy the national public records search requirement, firms should search reasonably available public records, including for general information such as an individual's name and address (e.g., by checking a valid state-issued driver's license or government-issued passport); criminal records; bankruptcy records; civil litigations and judgments; liens and business records. Firms may conduct the records search in a variety of ways, including through the use of credit reports, reputable public databases or utilizing the services of a specialized provider. To the extent it is not practical to verify all of the information in Form U4, a firm should document what information could not be verified and the reason therefore. While the public records search requirement does not extend to foreign jurisdictions, firms may find it necessary to search records in a foreign jurisdiction as part of their verification process (to the extent consistent with applicable law). FINRA also notes that firms must make their own determination about whether an applicant's consent on a Form U4 complies with the laws of any particular jurisdiction regarding consent to obtain investigative consumer reports.

FINRA is also establishing a temporary program to refund Late Disclosure Fees assessed for late filing of responses to Form U4 Question 14M (unsatisfied judgments or liens) if the amendment is filed and either (1) the judgment or lien has been satisfied, when it was unsatisfied it was under \$5,000, and the date it was filed with a court was on or before August 13, 2012; or (2) the unsatisfied judgment or lien was satisfied within 30 days after the individual learned of it. The temporary program has a retroactive effective date of April 24, 2014 and will automatically sunset on July 31, 2015.

The refund program will provide firms with an opportunity to report previously underreported information. The temporary program will run concurrently with FINRA's one-time search of certain financial and criminal public records on all registered persons, which is also intended to verify whether material information has been accurately reported to the CRD system. Firms should also use this time to review the adequacy of their current investigation protocols and develop and implement written verification procedures.

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