



white paper

# **NEW RULE REQUIRES FINRA FIRMS**

to Investigate Applicants and Verify Registration  
Information through Public Record Searches

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## NEW RULE REQUIRES FINRA FIRMS TO INVESTIGATE APPLICANTS AND VERIFY REGISTRATION INFORMATION THROUGH PUBLIC RECORD SEARCHES

In an attempt to streamline and clarify FINRA members' obligations relating to background investigations, the Securities and Exchange Commission (SEC) has recently approved FINRA Rule 3110(e): Responsibility of Member to Investigate Applicants for Registration (the "Rule").

The Rule becomes effective on July 1, 2015, and expands the background investigations that member firms are required to conduct on applicants. Most notable among the Rule's requirements is a mandate that members adopt written background check procedures that include a national search of "reasonably available" public records as well as a

clarification on the timing of the various background check and investigation requirements. The Rule also reiterates an existing requirement that members investigate the good character, business reputation, qualifications and experience of an applicant before registering the applicant with FINRA and encourages members to conduct the newly required public records search prior to filing the Form U4 as a best practice.

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## BACKGROUND & IMPETUS TO RULEMAKING

FINRA's Rule 3110(e) is actually based in part on previously existing rules, including NASD Rule 3010(e) and NYSE Rule 345.11. The Rule also incorporates previously existing requirements set forth on the Form U4 that continue to remain in place.<sup>1</sup>

### 1. NASD Rule 3010(e)

NASD Rule 3010(e) had previously imposed a responsibility and duty on members to ascertain by investigation the good character, business reputation, qualifications and experience of any person prior to making such a certification in the application of such person for registration with FINRA.

### 2. Form U4 Requirements

Prior to the Rule, language on the Form U4 imposed certain requirements on firms that continue to remain in place. This includes a requirement that firms take steps to verify the accuracy and completeness of the information provided on the Form U4, and a requirement that firms contact the applicant's employers from the previous three years and have documentation on file with the names of the persons contacted and the date of contact.

### 3. NYSE Rule 345.11

In addition, the previously existing NYSE Rule 345.11 also required member organizations to investigate the previous records of persons whom the organization contemplated employing. This investigatory requirement would be satisfied when the member organization fulfilled its aforementioned obligation to verify the information contained in the Form U4.

<sup>1</sup> See FINRA, FORM U4: UNIFORM APPLICATION FOR SECURITIES INDUSTRY REGISTRATION OR TRANSFER (2009), available at [https://www.finra.org/sites/default/files/Forms\\_U4\\_030315.pdf](https://www.finra.org/sites/default/files/Forms_U4_030315.pdf).

FINRA's adoption of the Rule is an attempt to consolidate, streamline and clarify all of these previously existing requirements. For example, the aforementioned NASD rule only stated that members had to conduct an investigation before they could make a certification to that effect in a person's application, but that rule did not explicitly require that the investigation be done before applying for registration with FINRA. So—at least in theory—a firm could try to file for registration without including the certification and without doing the investigation. The new Rule attempts to close these loopholes and sets forth a more streamlined process that is easier for member firms to comply with.



## RULE 3110(E)'S REQUIREMENTS ON MEMBER FIRMS

### 1. Investigation Requirement

First, the Rule clarifies that members must ascertain by investigation the good character, business reputation, qualifications and experiences of an applicant before the member applies to register the applicant with FINRA and before making a representation to that effect on the application for registration. This is essentially a restatement of the previously mentioned NASD rule, but with an explicit clarification that firms must conduct this investigation before applying to register the applicant with FINRA.

### 2. Verification Requirement

Second, the Rule requires that members “establish and implement written procedures reasonably designed to verify the accuracy and completeness of the information contained in an applicant's initial or transfer Form U4.” This requirement is elaborated further, stating that a member's written procedures must, at a minimum, provide for a search of “reasonably available public records.” The public records search can be conducted either by the member firm or through a third-party service provider.

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FINRA has stated that the definition of “reasonably available public records” may change over time, but some records it currently believes to be reasonably available include criminal records, bankruptcy records, judgments and liens.<sup>2</sup> This is, however, a minimum or base requirement—“firms may find it necessary to conduct a more in-depth search of public records depending on the applicant’s job function, responsibilities, or position at the firm.”<sup>3</sup> These additional public records could include civil litigation and business records.

Further, “FINRA does not expect firms to verify all of the information in the Form U4 where such verification is not feasible or practical. However, in such cases, a firm should document that the information could not be verified and the reasons (including the steps taken to verify the information).”<sup>4</sup>

### 3. Timing

The first requirement—that members ascertain by investigation the good character, business reputation, qualifications and experience of an applicant—must be done before the member applies to register the applicant with FINRA. The second requirement—a search of reasonably available public records—must be done no later than 30 calendar days after the Form U4 is filed with FINRA, with the understanding that if the firm becomes aware of any discrepancies as a result of the verification process conducted after the filing of the Form U4, it will be required to file an amended Form U4. However, FINRA has emphasized that the verification process is not limited to only the 30 days following the filing of a Form U4, and can be done prior to this time period. “The 30-day window

is intended to accommodate firms that may find it difficult to conduct the verification process before filing an applicant’s Form U4, such as where an applicant is hired immediately to fill a needed role at the firm.”<sup>5</sup>

In response to comments asking whether the investigation and verification requirements are duplicative, FINRA stated that the requirements are complimentary but not the same. FINRA noted that the investigation requirement is a principle-based requirement that requires members to use the resources that are necessary and lawful in order to investigate the background of an applicant.<sup>6</sup> The verification requirement specifically asks that the member verify the information contained on the Form U4. Although the two requirements are separate, some of the information obtained while satisfying these two requirements may overlap. Thus, for most applicants, FINRA expects that firms will conduct the investigation and verification process concurrently using some of the same information and prior to filing the Form U4.<sup>7</sup> This will also be a best practice for member firms because it will allow them to avoid any late disclosure fees that may be incurred if the search is conducted after filing the Form U4.

<sup>2</sup> See *Regulatory Notice 15-05*, FINRA 4 (2015), available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Notice\\_Regulatory\\_15-05.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-05.pdf).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 3.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at 2.

<sup>7</sup> *Id.* at 3-4.



## IMPLEMENTATION OF RULE 3110(E)

In order to implement the Rule, firms will first need to identify the information on the Form U<sub>4</sub> that can be verified, then establish a written policy that spells out how the firm will verify this information. This process can vary firm by firm. The following is a non-exhaustive list of how some of the information in the various sections of the Form U<sub>4</sub> can be verified.

### 1. Credit Report Header Information

The information in Section 1: General Information, Section 9: Identifying Information, Section 10: Other Names and Section 11: Residential History can all be verified using the header information of a credit report. This search can be used to verify that the name and social security number provided by the applicant matches the credit header. This search will also reveal any AKAs or alias names used by the applicant. Additionally, this search will reveal any past addresses associated with the applicant.

### 2. Professional Designation Search

The information contained in Section 8: Professional Designations can be verified by contacting the issuing bodies and confirming that the applicant holds the professional designations listed on the Form U<sub>4</sub>.

### 3. Employment History

Firms can verify the information in Section 12: Employment History by contacting each employer to verify the dates of employment and the positions held. FINRA has stated that it expects firms to verify the full ten-year employment history listed on the Form U<sub>4</sub>.

### 4. Disclosures

Firms can verify the information in the criminal disclosure section through

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a fingerprint-based FBI search. This is done by associating the applicant and getting fingerprints, then comparing the results with the information provided on the Form U4. Firms can also conduct name-based criminal searches through county and federal courthouses based on the applicant's areas of residence and/or employment.

Regulatory action disclosures can be verified using FINRA's BrokerCheck system and/or Business Information Group's ActionsBase search. FINRA's BrokerCheck can be searched for any disclosable derogatory information, including regulatory actions. BIG's ActionsBase can be searched for publicly available disciplinary and administrative actions, including information actively collected from the SEC, CFTC and hundreds of other federal, state and foreign financial regulatory authorities. ActionsBase also includes publicly available disciplinary and administrative actions taken against licensed professionals, including attorneys and accountants, as well as a search of the GSA's SAM list of excluded federal contractors.

Firms can also verify customer complaint, arbitration and civil litigation disclosures using FINRA's BrokerCheck system.

Civil judicial disclosures and financial disclosures can be verified using data from a credit report. This search can reveal civil matters such as liens and judgments as well as bankruptcy filings. This search will also provide the firm with the individual's full credit report and financial history



as maintained by one of the three major credit bureaus.

Finally, termination disclosures can be verified using the research conducted while verifying employment history information. When each employer is contacted to verify employment history they should be asked about the applicant's reason for leaving and whether the individual is eligible for rehire.

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## FCRA COMPLIANCE FOR OUTSOURCED SEARCHES

One important aspect of applicant screening that is often overlooked is a requirement that the proper authorization be procured from the applicant prior to running the various checks.

Firms that plan to conduct the aforementioned checks in-house without seeking the assistance of any third parties can use the Form U4 to obtain the applicant's authorization. However, the authorization in the Form U4 is not sufficient to authorize a firm to conduct a background check through a third party prior to registration.

If a firm decides to outsource any portion of the background investigation process, the requirements of the federal Fair Credit Reporting Act (FCRA) become applicable. The FCRA applies to any company who uses a third-party background screening firm (formally known as a "consumer reporting agency") and requires that the company provide the applicant subject to screening with a "clear and conspicuous disclosure . . . in a document that consists solely of the disclosure, that a consumer report may be obtained for employment purposes."<sup>8</sup>

The FCRA also requires the company to obtain the consumer's written authorization to conduct a background check. The Federal Trade Commission (or FTC) has made clear—as have the courts—that Section 604(b)(2) of the FCRA does allow the authorization to be part of this stand-alone document, but no other information can be included. The Form U4's authorization includes language allowing a firm to file documents electronically, information on service of process, a release of liability, as well as other extraneous information that

<sup>8</sup> *Fair Credit Reporting Act*, Pub. L. 90-321, Title VI, codified at 15 U.S.C. 1681 et seq.

is not consistent with the FCRA’s “stand-alone” requirement. Thus, the authorization in the Form U4 is not sufficient for a consumer to authorize a background check to be procured from a third party.

Prior to conducting the aforementioned background checks and investigations, members should ensure that their policies and procedures are in full compliance with all applicable employment laws, which includes the aforementioned Fair Credit Reporting Act and the states’ analogous laws.



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