

that has willfully violated securities laws or failed to supervise an employee who violated securities law. The Act goes on to say, however, that supervisors will not have failed in their duties if a supervisory system is in place that can successfully detect and prevent violations.

For this system, each member firm is required to have a written description of supervisory responsibilities and a set of written supervisory procedures that will govern the activities of its registered employees. The firm must make sure that there are supervisory controls and periodic inspections that check that the procedures are being complied with.

But first some pertinent definitions.

### 3.1.1. FINRA MEMBER OFFICE DESIGNATIONS

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#### 3.1.1.1. Office of Supervisory Jurisdiction (OSJ)

An Office of Supervisory Jurisdiction is one that demands special supervisory attention, either because FINRA deems that the activities conducted there have particular regulatory significance or because the member firm itself believes it prudent or necessary based on certain FINRA guidelines.

Under FINRA rules, the execution of any one of the following critical activities requires that an office be designated an OSJ:

- Order execution or market making
- Structuring of public offerings or private placements
- Maintaining custody of customer funds or securities
- Final approval of new customer accounts
- Review and endorsement of customer orders
- Final approval of advertising or sales literature
- Supervision of activities of persons at one or more of the member firm's branch offices

The member firm must designate other offices as OSJs where (1) they involve activities that require regular contact with public customers, (2) they are geographically remote from another OSJ or geographically dispersed, (3) a substantial number of registered employees conduct securities activities there, and (4) the securities activities are diverse or complex.

#### 3.1.1.2. Branch Office

A branch office is any location where one or more associated employees is in the business of soliciting or effecting (but not executing) the purchase or sale of any security. An office responsible for supervising the activities of employees at one or more non-branch locations of the member firm is also designated a branch office.

#### 3.1.1.3. Non-Branch Locations

Unregistered offices, or non-branch locations, include (1) any office location established

solely for customer service and/or back office type functions where no sales activities are conducted and (2) an employee's private residence if:

- Only resident employees who are immediate family members operate there
- The employee does not meet with customers there
- Neither customer funds nor securities are handled at that location
- The location is assigned to a branch office and subject to the firm's supervision
- All orders are made through the designated branch office

Non-branch locations also include (3) locations used less than 30 business days per year for securities business and (4) the floor of a registered exchange where a member firm conducts business with public customers.

### 3.1.2. **SUPERVISORY SYSTEM**

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A supervisory system is a defined structure that specifies how a member firm should oversee the activities of its employees. FINRA requires that member firms set up a **supervisory system** that will:

- Define which member offices are designated as Offices of Supervisory Jurisdiction
- Describe how the OSJs are to be managed
- Establish a managerial chain of command and attest to the qualifications of the managers it hires
- Establish and keep current written supervisory procedures that instruct managers how to carry out their responsibilities
- Conduct an annual compliance meeting with each of its principals and representatives

The overall purpose of the supervisory system is to establish responsibility within the member firm to ensure regulatory and legal compliance.

#### 3.1.2.1. **Designation of OSJ General Principal**

Each OSJ is required to designate at least one General Principal to be responsible for the supervision not only of the activities of the registered representatives and other principals in its own office, but also in any branch office under its jurisdiction. This General Principal must be physically present at the OSJ she supervises on a regular and routine basis. Among the General Principal's supervisory responsibilities are:

- The enforcement of the member firm's written supervisory procedures
- The periodic review of customer accounts
- The maintenance of customer records, including customer complaints
- The periodic inspection of its branch offices

No single individual may be designated to supervise more than one OSJ.

### 3.1.2.2. Chain of Command

Every branch office is required to designate at least one General Representative or General Principal with the supervisory authority and responsibility over the activities of that office and any non-branch offices in its jurisdiction. In addition, an appropriately registered limited principal must be assigned supervisory authority for each type of the member firm's business that requires registration as a broker-dealer. A Series 9/10 Principal, for example, would be assigned oversight responsibility for equities sales in each OSJ. Finally, to provide a clear line of authority, each registered person must be assigned at least one supervisor. A supervisory system therefore designates a person responsible for each office, each registered activity, and each registered employee of the member firm.

### 3.1.2.3. Supervisory Qualifications

The qualifications for a supervisory position should be clearly laid out in a member firm's written supervisory procedures. Passing the requisite qualifying exam is critically important, but candidates must also have the experience, training, and discipline to conduct the responsibilities of that office. Nor should the member firm rely merely on a candidate's statements. Member firms are expected to make reasonable efforts to confirm a candidate's qualifications.

### 3.1.2.4. Compliance Meeting

Each associated person must participate in an annual compliance meeting or interview. The purpose of this meeting is to ensure that representatives and principals remain current on changing compliance requirements and the firm's supervisory system. Meetings may be conducted either individually or among a group of representatives, but the meeting must cover compliance matters relevant to the activities of the attendees.

Firms are not required to conduct in-person meetings with its registered persons to comply with the annual compliance meeting. However, compliance meetings using other methods, such as on-demand webcast or video conference, must ensure that each registered person attends the entire meeting and is able to ask questions regarding the presentation and receive answers in a timely fashion.

## 3.1.3. WRITTEN SUPERVISORY PROCEDURES (WSPs)

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Recall that the supervisory system describes how the responsibility for regulatory compliance is shared within the member firm. The **written supervisory procedures (WSPs)** document the supervisory system and instruct supervisors how to perform their responsibilities.

The member firm's WSPs must record the names, titles, registration status, and locations of all its supervisory personnel and their responsibilities. They must also maintain on record the date that all supervisory personnel were assigned their duties.

Written supervisory procedures must also instruct each supervisor how to monitor whether the personnel under his supervision have followed proper procedures. If a supervisor uncovers suspicious activity, the written procedures must clearly define how to report the activity. The WSPs should instruct supervisors how to document their oversight activities.