

## Membership Application Proceedings

### FINRA Requests Comment on a Proposal Regarding the Rules Governing the New and Continuing Membership Application Process

Comment Period Expires: October 5, 2018

#### Summary

FINRA seeks comment on proposed amendments to the NASD Rule 1010 Series (Membership Proceedings) (collectively, the Membership Application Program (MAP) rules). The proposal is the result of FINRA's retrospective review of the MAP rules and processes, and is intended to reduce unnecessary burdens on new and existing firms, while strengthening investor protections. The proposed amendments would replace the NASD Rule 1010 Series with the proposed FINRA Rule 1100 Series (New and Continuing Membership). The proposed amendments would also include additional provisions to address regulatory issues FINRA staff identified and codify existing membership-related interpretations and practices.

A chart detailing the restructuring of the proposed rules and the text of the proposed rules are set forth in [Attachments A](#) and [B](#), respectively.

Questions regarding this *Notice* should be directed to:

- ▶ Kosha Dalal, Associate Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903;
- ▶ Sarah Kwak, Assistant General Counsel, OGC, at (202) 728-8471; and
- ▶ Alissa Robinson, Senior Director, Membership Application Program, at (212) 858-4764.

Questions concerning the Economic Impact Assessment in this *Notice* should be directed to:

- ▶ Lori Walsh, Senior Director, Office of the Chief Economist (OCE), at (202) 728-8323; and
- ▶ Dror Kenett, Economist, OCE, at (202) 728-8208.

July 26, 2018

#### Notice Type

- ▶ Request for Comment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management
- ▶ Systems

#### Key Topics

- ▶ Continuing Membership
- ▶ Membership Rules
- ▶ New Membership

#### Referenced Rules & Notices

- ▶ FINRA By-Laws Article I(h), Article I(rr) and Section 1 of Article IV
- ▶ FINRA By-Laws Section 4(i) of Schedule A
- ▶ FINRA Rules 4110, 4120, 4311, 4370, 9143, 9160, 9235, 9242, 9251, 9252, 9262, 9263, 9264, 9311, 9322, 9347 and 9349
- ▶ FINRA Rule 9000 and 9300 Series
- ▶ NASD Rule 1010 Series
- ▶ NASD Rules 1021, 1090 and 3140
- ▶ Notices to Members 97-19, 98-38 and 00-73
- ▶ NYSE Rules 311, 312, 313 and 321
- ▶ NYSE Rule Interpretations 311(f) and (g)
- ▶ Regulatory Notices 08-66, 09-42, 10-01, 13-29, 15-10, 18-06, 18-15 and 18-16
- ▶ SEA Rules 15c3-1, 15c3-3 and 17a-11
- ▶ SEA Section 3(a)(39)
- ▶ Securities Investor Protection Act of 1970



## Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by October 5, 2018.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto:pubcom@finra.org); or
- ▶ Mailing comments in hard copy to:  
Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment.

**Important Notes:** All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.<sup>1</sup>

The proposed rule change must be filed with the Securities and Exchange Commission (SEC or Commission) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).<sup>2</sup>

## Background & Discussion

The MAP rules govern the way in which FINRA's Department of Member Regulation, through the Membership Application Program Group (together, the Department), reviews new membership applications (NMAs) and continuing membership applications (CMAs).<sup>3</sup> These rules require an applicant to demonstrate its ability to comply with rules and laws including observing high standards of commercial honor and just and equitable principles of trade applicable to its business. The Department evaluates an applicant's financial, operational, supervisory and compliance systems to ensure that each applicant meets the standards set forth in the MAP rules. Among other elements, the MAP rules require consideration of whether an applicant and persons associated with an applicant have disciplinary actions taken against them by FINRA and other industry authorities, customer complaints, adverse arbitrations, pending or unadjudicated matters, civil actions, remedial actions imposed, or other industry-related matters that could pose a threat to public investors. Finally, the MAP rules provide for the administration of the MAP appeal process, setting forth specified time periods for holding hearings and satisfying document production requests, the evidence and testimony that may be considered, and the information that the applicant is required to provide to FINRA.

In [\*Regulatory Notice 15-10\*](#) (March 2015), FINRA launched a retrospective review of the MAP rules to assess opportunities to improve their effectiveness and efficiency.<sup>4</sup> The retrospective review confirmed that while the rules largely have been effective in meeting their intended investor protection objectives, the rules could benefit from some updating and recalibration to better align their investor protection benefits with their economic impacts. Consistent with a number of recommendations by stakeholders<sup>5</sup> during the retrospective review, FINRA is proposing amendments to the MAP rules to address these and other concerns while maintaining strong investor protections. The proposed amendments to the MAP rules would include the following key changes:

- ▶ restructure the MAP rules to make them more streamlined and eliminate procedural redundancy between NMAs and CMAs;
- ▶ codify current Department practices aimed at reducing the overall application review period from 180 days to 150 days, such as the initial assessment of an application to determine whether it can proceed under standard review timeframes set forth under the MAP rules or expedited timeframes (*i.e.*, “Fast Track”<sup>6</sup>), and the materiality consultation process;
- ▶ modify the NMA and CMA processes by, among other things, amending definitions and standards for granting or denying an application, and clarifying the ability of the Department to reject and lapse an application;
- ▶ modify the CMA process by, among other things, clarifying the events that would require a CMA (*e.g.*, change in ownership or control), and eliminating the related ability of the Department to impose interim restrictions pending review; and
- ▶ streamline and update the rules relating to the MAP appeal process by codifying current practices and updating terminology and concepts to align more closely with the Rule 9000 Series (Code of Procedure).

While many of the proposed amendments are technical and administrative in nature, the proposal is responsive to the issues raised during the assessment phase of the retrospective review. The proposal clarifies a number of provisions or terms; amends or deletes provisions that need recalibration or have become outdated; and streamlines the rule and its attendant processes by eliminating or consolidating duplicative provisions and codifying existing Department practices. As a result, FINRA believes the proposal strikes an appropriate balance between maintaining strong investor protections and enhancing the efficiency of the MAP rules and processes.

### Structure of the MAP Rules

FINRA proposes to restructure the MAP rules, which currently consist of 11 rules, by organizing them into six distinct areas (See Attachment B):

- ▶ General Provisions
- ▶ New Membership
- ▶ Continuing Membership
- ▶ Standards for Approval of Application
- ▶ Department Decision
- ▶ Review of Department Decision

### General Provisions (Proposed FINRA Rule 1110 Series)

The rules contained within the proposed FINRA Rule 1110 Series are intended to address the aspects of the membership process that are common to NMAs and CMAs.

#### A. Definitions (Proposed FINRA Rule 1111)

##### 1. “Application”

The proposed rule would define, for the first time, the term “Application” to refer to either an NMA (or Form NMA) or a CMA (or Form CMA) depending on the context. This label is intended to improve the readability of the MAP rules.

##### 2. “Associated Person”<sup>7</sup>

FINRA is proposing to amend the definition of the term “Associated Person” in NASD Rule 1011(b) to include a member of a limited liability company as an Associated Person. In addition, the proposed rule would exclude from the definition any person with a *de minimis* ownership interest (*i.e.*, less than 10 percent) in a partnership, corporation, association or other legal entity, unless that person is entitled, under the legal entity’s constituent documents, to 10 percent or more of such entity’s profits or distributions or otherwise controls the applicant. This proposed *de minimis* exclusion would provide greater clarity regarding the Associated Person status of owners with small ownership interests in the applicant that do not otherwise control the applicant by virtue of an entitlement to significant portions of an applicant’s profits or distributions or otherwise have the power, directly or indirectly, to control the applicant.<sup>8</sup>

##### 3. “Control”<sup>9</sup>

FINRA is proposing to define, for the first time, the term “control.” Currently, the Department relies on the definition of “controlling” under the FINRA By-Laws.<sup>10</sup>

The proposed definition for purposes of the MAP rules is derived, in part, from the existing FINRA By-Laws definition, but differs, most notably, by increasing the threshold establishing the presumption of control from 20 percent to 25 percent and including more factors that would lead to a presumption of control. The additional factors are derived, in part, from the definition of “control” in Form BD,<sup>11</sup> but, consistent with the existing FINRA By-Laws definition, the definition replaces the references to “company” with “person,” which is defined in Rule 0160 to include “any natural person, partnership, corporation, association, or other legal entity.”<sup>12</sup> In addition, the proposed definition would add “limited liability company” as another legal entity to reflect that such entity is a common organizational structure.

The proposed new definition would define “control” to mean the possession of the power to direct or cause the direction of the management or policies of a person whether through ownership of voting securities, by contract or otherwise. Under the proposed definition, control over a person would be presumed if such person, directly or indirectly:

- (1) is a director, general partner, managing member, or officer or principal exercising executive responsibility (or person occupying a similar status or performing similar functions) of the other person;
- (2) has the right to vote 25 percent or more of a class of voting securities;
- (3) has the power to sell or direct the sale of 25 percent or more of a class of voting securities;
- (4) is entitled to receive 25 percent or more of the profits; or
- (5) in the case of a partnership or limited liability company, has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital.

In addition, the proposed definition would clarify that ownership interests of less than 25 percent would not preclude aggregation of such interests for the presumption of control. The proposed definition also would provide that the presumption of control may be rebutted by proving that any of the factors listed above does not exist or by showing other factors that negate the presumption of control. Finally, the proposed definition would set forth that the presumption would not apply where such person holds voting securities of the applicant, in good faith, as an agent, bank, broker, nominee, custodian or trustee for one or more owners who do not individually or as a group have control of such entity.

FINRA believes that defining “control” for purposes of the MAP rules lends clarity and consistency to the control standards under proposed Rule 1131 (Continuing Membership Application Process) described below.

#### 4. “Sales Practice Event”<sup>13</sup>

Currently, the term “sales practice event” means any customer complaint, arbitration or civil litigation that has been reported to the Central Registration Depository (CRD<sup>®</sup>) or otherwise has been reported to FINRA. FINRA is proposing to expand the term to include a “statutory disqualification,” as defined in Section 3(a)(39) of the Exchange Act, of an applicant or Associated Person.<sup>14</sup>

#### 5. Other Proposed Amendments to Definitions

FINRA is proposing to make several non-substantive changes to the definitions to correct cross-references, relocate portions to other rules as part of the restructuring or update the terminology consistent with other FINRA rules.

### B. General Procedures (Proposed FINRA Rule 1112)

Currently, NASD Rule 1012 (General Provisions) sets forth the methods of delivery of an NMA or CMA, and their corresponding documents or information. The rule also addresses the Department’s service of notice and decision on an application, application lapse, prohibitions on ex parte communications with applicants or Interested FINRA Staff, recusals or disqualifications of Governors and members of the National Adjudicatory Council (NAC) or Subcommittee, and the computation of time periods.

FINRA is proposing to adopt NASD Rule 1012, with amendments, as proposed Rule 1112. The proposed changes would first, move the provisions pertaining to the prohibitions on ex parte communications, and recusals or disqualifications to the proposed Rule 1160 Series (Review of Department Decision) described below, and the computation of time periods to proposed Rule 1111. Second, the proposed changes would bring together under a single rule the provisions common to the review of NMAs and CMAs. These common provisions currently reside under NASD Rules 1012, 1013 (New Member Application and Interview) and 1017 (Application for Approval of Change in Ownership, Control, or Business Operations) as described below.

#### 1. Filing and Service; Timing—Proposed FINRA Rule 1112(a)

Currently, NASD Rule 1012(a) requires an applicant to file an NMA or CMA in the manner prescribed under NASD Rule 1013 or 1017, as appropriate, along with the timely submission of an application fee pursuant to Schedule A to the FINRA By-Laws. Paragraph (a) sets forth the various channels through which an applicant may file its application, documents or information with the Department, and the methods by which the Department must serve notice or a decision upon the applicant. Paragraph (a) also specifies when a filing by an applicant or service by the Department is deemed complete depending upon the delivery method.

FINRA is proposing to delete NASD Rule 1012(a) in its entirety, and adopt proposed Rule 1112(a). The proposed rule would:

- ▶ update the method for delivering and filing applications to move away from paper-based methods to an electronic process or such other process as FINRA may prescribe;<sup>15</sup>
- ▶ clarify the starting times for submitted and filed applications for purposes of calculating the time by which the Department must issue its decision on an application; and
- ▶ expressly provide that the timeframes specified in the MAP rules may be extended or shortened upon the mutual written consent of the Department and the applicant.

## **2. Rejection of Application Following Department's Initial Assessment—Proposed FINRA Rule 1112(b)**

NASD Rules 1013(a)(3) and 1017(d), which pertain to NMAs and CMAs, respectively, contain nearly identical language for applications that are “not substantially complete” at the time of filing. These provisions give the Department 30 days from the date on which the applicant files the application to reject it as “not substantially complete” and deem it not to have been filed on the basis that the application is so deficient upon initial submission that the Department cannot begin reviewing it.<sup>16</sup> In such case, the Department is required to notify the applicant of the reasons underlying the rejection and refund the application fee, less a \$500 processing fee. If the applicant determines to apply for approval of an NMA or CMA, the applicant is required to submit a new application and appropriate fee pursuant to Schedule A to the FINRA By-Laws.

FINRA is proposing to delete NASD Rules 1013(a)(3) and 1017(d) in their entirety, and adopt proposed Rule 1112(b) to reflect current Department practices in handling applications that are deficient upon submission (“Application Submission Date”). The proposed rule would eliminate the concept of an application that is “not substantially complete” at the time of filing and instead, more appropriately focus on whether there are sufficient documents and information accompanying the application for the Department to commence a meaningful review and deem it “filed” for purposes of calculating the date on which the decision is due (“Application Filed Date”).

Under the proposed rule, the Department would have 15 days from the Application Submission Date (as that term is defined under proposed Rule 1112(a)) to conduct an initial assessment to determine whether an application includes the documents or information necessary for the Department to conduct a meaningful review.<sup>17</sup> Should the Department determine that the application does not contain sufficient documentation or information to begin a meaningful review, the Department would be required to provide the applicant with written notification of the deficiency. An applicant would then have five business days after notification to cure the deficiency, and failure to timely do so would result in the Department's rejection of the application. In such case, the applicant would receive a

refund of the application fee, less a \$500 processing fee. If the applicant determines again to apply for approval of an NMA or CMA, the applicant would be required to submit a new one and the appropriate fee pursuant to Schedule A to the FINRA By-Laws. The proposed rule would also clarify that an application that has been rejected does not constitute final action by the Department for purposes of the proposed Rule 1160 Series.

### **3. Request for Additional Documents or Information—Proposed FINRA Rule 1112(c)**

NASD Rules 1013(a)(4) and 1017(e), which pertain to NMAs and CMAs, respectively, permit the Department to request, at any time during the application review process, any additional information or documents necessary to render a decision on the application. Depending on whether the application is for new or continuing membership, the provisions provide differing timeframes for when the Department must serve its request on the applicant and when the applicant must respond to such request.

For an NMA, NASD Rule 1013(a)(4) requires the Department to serve its initial request for any additional information or documents necessary to render a decision on the application within 30 days after the application is filed. Unless otherwise agreed to by the Department and the applicant, the applicant is required to file any additional information and documents with the Department within 60 days thereafter, and for any subsequent requests for information or documents that the Department may serve, the applicant has 30 days in which to respond to such request. For a CMA, NASD Rule 1017(e) requires the Department to serve a request for any additional information or documents necessary to render a decision on the application within 30 days after the application is filed. An applicant has 30 days in which to respond to any such request (unless otherwise agreed to by the Department and the applicant).

FINRA is proposing to consolidate and adopt NASD Rules 1013(a)(4) and 1017(e), with amendments, as proposed Rule 1112(c). The proposed changes would eliminate the timing differences based on application type. Under the proposed rule, the Department would be required to serve its initial request for any additional documents or information within 30 days after the Application Filed Date (as that term is defined under proposed Rule 1112(a)), and the applicant must respond to the initial request within 30 days after service. In addition, the applicant would be required to respond to any subsequent request for documents or information within 15 days after the Department's request or within such other time period agreed to by the Department and the applicant.

### **4. Lapse of Application—Proposed FINRA Rule 1112(d)**

Currently, NASD Rule 1012(b) gives the Department the authority to lapse an NMA or CMA, if, absent a showing of good cause, the applicant fails to timely respond to the Department's request for additional documents or information (or within such other period agreed to by the Department and the applicant), appear at or otherwise participate in a scheduled membership interview, or file an executed membership agreement within



25 days after service of the agreement (or within such other period agreed to by the Department and the applicant). An applicant that determines again to seek approval of its application is required to submit a new one (under either NASD Rule 1013 or 1017, as appropriate) and the appropriate fee pursuant to Schedule A to the FINRA By-Laws.

FINRA is proposing to adopt NASD Rule 1012(b), with amendments, as proposed Rule 1112(d). The proposed amendments would add a new event that would result in an application to lapse. Currently, the MAP rules provide a 180-day timeframe in which the Department must issue a written decision on an application.<sup>18</sup> During this timeframe, the Department has experienced, with some frequency, applicants that make substantial changes to their applications well into the review process.<sup>19</sup> To curtail these situations, FINRA is proposing to add a new provision to provide that in instances where an applicant makes a substantial change to the application that materially impacts the Department's review of the application, the Department would have the authority to lapse the application. Under the proposed rule, the Department would be required to notify the applicant, in writing, of the pending lapse and the applicant would have five business days from notification to remedy the application. The applicant's failure to timely remedy the application would result in its lapse.

Under the proposed rule, an application that has lapsed within 30 days after the Application Filed Date would result in a refund to the applicant of the application fee, less a \$500 processing fee. An application that has lapsed after 30 days of the Application Filed Date would not result in a refund of the application fee. An applicant that determines again to seek approval of its application would be required to submit a new one and the appropriate fee pursuant to Schedule A to the FINRA By-Laws. The proposed rule would also clarify that an application that has lapsed does not constitute final action by the Department for purposes of the proposed Rule 1160 Series.

#### **5. Withdrawal of Application—Proposed FINRA Rule 1112(e)**

NASD Rules 1013(a)(5) and 1017(f), which pertain to NMAs and CMAs, respectively, contain nearly identical language permitting an applicant to withdraw its application. If the applicant withdraws the application within 30 days after filing the application, FINRA will refund the application fee, less a \$500 processing fee. An applicant that determines again to seek approval of its application is required to submit a new one (under either NASD Rule 1013 or 1017, as appropriate) and the appropriate fee pursuant to Schedule A to the FINRA By-Laws.

FINRA is proposing to revise these rules as proposed Rule 1112(e). The proposed changes would clarify that if an applicant withdraws the application after the Application Submission Date, but not later than 30 days after the Application Filed Date, FINRA will refund the application fee, less a \$500 processing fee. The proposed rule would also clarify that an applicant that withdraws its application after 30 days of the Application File Date

would not receive a refund of the fee. Finally, the proposed rule would clarify that an application that has been withdrawn does not constitute final action by the Department for purposes of the proposed Rule 1160 Series.

#### **6. Membership Interview—Proposed FINRA Rule 1112(f)**

FINRA is proposing to revise NASD Rules 1013(b) and 1017(g) as proposed Rule 1112(f) to address the membership interview process for NMAs and CMAs, expressly providing that an interview for a new member applicant is mandatory, and discretionary for a continuing member applicant. Proposed paragraph (f) would retain the requirement that the Department conduct the interview in the district office for the district in which the applicant has its principal place of business or at an agreed upon location, and allow the flexibility to conduct more than one membership interview and permit the interview(s) to occur by video conference or by other means. Proposed Rule 1112(f) would also retain the current seven-day timeframe in which the Department must provide the applicant written notice of the interview, but update the delivery method to move away from paper-based methods such as facsimile or overnight courier to an electronic process or such other process as FINRA may prescribe as specified under proposed Rule 1112(a).

#### **7. Proposed Supplementary Materials**

##### **▶ Initial Assessment by Department (Supplementary Material 1112.01)**

FINRA is proposing to add new Supplementary Material .01 to proposed Rule 1112 to codify an existing procedure to conduct an initial assessment of an application. Specifically, the proposed supplementary material would provide that the Department shall conduct an initial assessment of an application to determine, at a minimum, whether the documents or information included with the application are correctly identified and contain the information they purport to address and whether the application may be eligible for expedited review. The proposed supplementary material would further describe that as part of the initial assessment, the Department may also review several aspects of the application including, but not limited to, the disciplinary history of the applicant and its Associated Persons, and scale and scope of the proposed activities of the applicant, the history of sales practice events, disciplinary history, licenses and registrations, and experience of the relevant principals and registered persons of the applicant, and the written supervisory procedures.

##### **▶ Department Decision to Expedite Review (Supplementary Material 1112.02)**

FINRA is proposing to add new Supplementary Material .02 to proposed Rule 1112 providing that as part of the initial assessment, the Department may, in its discretion, determine that the application is eligible for expedited review and notify the applicant of such eligibility.

▶ **Membership Interview (Supplementary Material 1112.03)**

FINRA is also proposing to add new Supplementary Material .03 to proposed Rule 1112 to codify existing guidance on membership interviews.<sup>20</sup> The proposed supplementary material would provide a general description of the membership interview and the topics that may be discussed during the interview to demonstrate the applicant's ability to satisfy the standards for approval of an application. Topics would include the nature and scope of the business, financial condition, source of funds, the background and experience of the applicant's principals and representatives, documents or information that the Department obtained from CRD or a source other than the applicant and upon which the Department intends to base its decision, among others.<sup>21</sup>

▶ **Waiver of Two-Principal Requirement (Supplementary Material 1112.04)**

Rule 1210.01 requires that a member, except a member with only one Associated Person, have a minimum of two officers or partners who are registered as General Securities Principals, provided that, a member whose activities are limited in scope, may instead have two officers or partners who are registered in a principal category that corresponds to the scope of the member's activities.<sup>22</sup> The requirement that a member have a minimum of two principals applies to a broker-dealer seeking to become a new FINRA member, as well as an existing or continuing member. Rule 1210.01 provides that pursuant to the Rule 9600 Series (Procedures for Exemptions), FINRA may waive the requirement that a member have a minimum of two principals in situations that indicate conclusively that only one person associated with an applicant for new or continuing membership should be required to register as a principal.

In practice, an applicant submits its waiver request in writing, stating the basis on which the applicant believes it has demonstrated that only one person associated with the applicant should be required to be registered as a principal, along with any supporting documentation for the waiver request to the Department as part of the supporting documentation in Form NMA or Form CMA.<sup>23</sup> The decision on a two-principal waiver request is made by the Department.<sup>24</sup>

Currently, the MAP rules do not expressly address how an applicant may seek a waiver of the two-principal requirement, but Forms NMA and CMA address this waiver.<sup>25</sup> FINRA is proposing to add new Supplementary Material .04 to proposed Rule 1112 to make the nexus between the NMA and CMA processes and Rule 1210.01 more evident. In addition, the proposed supplementary material would describe the factors the Department may consider in determining whether to grant a waiver. Factors may include, but are not limited to, the regulatory history of the applicant and its Associated Persons, the type of business the applicant conducts or for which it is approved to conduct, and the number, location and experience of Associated Persons and their designated offices and locations. The proposed supplementary material would also set forth that the decision to grant the waiver rests with the Department, and the applicant's ability to appeal the decision pursuant to the

Rule 9600 Series. The proposed supplementary material would clarify that an appeal of the Department's decision on the waiver may cause the underlying application review process to be held in abeyance pending the outcome of the appeal.

## New Membership (Proposed FINRA Rule 1120 Series)

FINRA proposes to adopt a new rule series dedicated to the unique requirements and processes for new membership. The proposed Rule 1120 Series would encompass rules pertaining to membership waive-in, foreign members and the NMA process.

### A. Membership Waive-In (Proposed FINRA Rule 1121)

NASD Interpretative Materials 1013-1 and 1013-2 describe a waive-in application process to allow certain New York Stock Exchange (NYSE) and NYSE American LLC (NYSE American) (formerly, NYSE Alternext US LLC) member organizations to automatically become FINRA members and to register automatically all Associated Persons whose registrations are approved with either NYSE or NYSE American, as applicable, in registration categories recognized by FINRA. In general, upon such member organization's submission of a signed waive-in membership application to the Department, the Department is required to review the waive-in application within three business days of receipt and if complete, issue a letter notifying the applicant that it has been approved for FINRA membership.

FINRA is proposing to consolidate, with amendments, the Interpretative Materials as proposed Rule 1121. The proposed amendments would delete the description of the waive-in application process that was established in connection with the consolidation of NASD and NYSE Regulation, Inc. in 2007, which has now become obsolete, but would retain some aspects of the Interpretative Materials.<sup>26</sup> The proposed rule would clarify that a member organization would be required to execute a membership agreement prior to expanding its business operations, and that if such expansion would be considered a "material change in business operations" as that term is described under proposed Rule 1131(b), then such member organization would be required to undergo the CMA process described under the proposed Rule 1130 Series. The proposed rule would also provide that upon approval of the business expansion, the member organization would be subject to all NASD rules, in addition to the consolidated FINRA rules and those NYSE rules incorporated by FINRA.

### B. Foreign Members (Proposed FINRA Rule 1122)

NASD Rule 1090 (Foreign Members) requires a foreign broker-dealer that does not maintain an office in the United States responsible for preparing and maintaining regulatory filings to meet specific requirements for FINRA membership. The requirements enable FINRA to ensure a foreign member's compliance with applicable securities laws and regulations, and with applicable FINRA rules. Paragraph (d) of the rule requires foreign members to "utilize, either directly or indirectly, the services of a broker-dealer registered with the Commission,

a bank or a clearing agency registered with the Commission located in the United States in clearing all transactions involving members of the Association, except where both parties to a transaction agree otherwise.” FINRA is proposing to adopt NASD Rule 1090, with one substantive change, as proposed Rule 1122.<sup>27</sup> The proposed change would delete NASD Rule 1090(d) because the provision is addressed by Rule 4311 (Carrying Agreements).

### **C. New Membership Application Process (Proposed FINRA Rule 1123)**

NASD Rule 1013 sets forth the requirements for an NMA, including how to file the application, the documents and information that must be submitted with the application,<sup>28</sup> and the requirement for an applicant to file its uniform registration forms (Forms U4, U5, BD) electronically. The rule also addresses the Department’s ability to reject an application that is “not substantially complete” and the Department’s ability to request additional documents or information, the applicant’s withdrawal of the application and the process for conducting the membership interview.

FINRA is proposing to revise NASD Rule 1013 as proposed Rule 1123. The proposed revisions would streamline the rule by moving to one consolidated rule, proposed Rule 1112, procedural elements of the NMA review process that are common with the CMA process, such as the procedures for application rejection, the request for additional documents or information, application withdrawal and the membership interview. The proposed rule also would add a new provision that would indicate the actions a prospective applicant would need to undertake before filing an NMA. Those actions would include, among others as FINRA may prescribe, filing Form BD with the SEC, reserving a firm name, completing the necessary forms to establish access to FINRA systems, submitting fingerprints for each Associated Person and paying the appropriate fee pursuant to Schedule A to the FINRA By-Laws.<sup>29</sup> Finally, FINRA is proposing to delete references to the detailed list of items because these items are already included in Form NMA or are referenced in the standards for admission.<sup>30</sup>

## **Continuing Membership (Proposed FINRA Rule 1130 Series)**

FINRA is proposing to adopt a new rule series dedicated to aspects of FINRA membership that are unique to continuing FINRA membership. The proposed Rule 1130 Series would encompass the rules pertaining to the CMA process, the circumstances that would obviate the filing of a CMA, the materiality consultation process and the safe harbor provision.

### **A. Continuing Membership Application Process (Proposed FINRA Rule 1131)**

Currently, NASD Rule 1017 describes the events requiring a CMA and sets forth the documents or information required to support the application, depending upon the nature of the application.<sup>31</sup> In addition, the rule sets forth the timing and conditions for filing a CMA. Most notably, for a member that is filing an application for approval of a change in ownership or control, the member must file the application at least 30 days before the

event takes place. While a member may effect such change prior to the conclusion of the Department's review of the application, the Department may place new interim restrictions on the member based upon the standards contained in NASD Rule 1014 (Department Decision) pending final action. For other specified events, a CMA for approval by the Department can be filed at any time before effectuating such event.

NASD Rule 1017 also addresses the Department's ability to reject an application that is "not substantially complete" and to request additional documents or information, the applicant's withdrawal of the application, the process for conducting the membership interview, the Department's decision on the application, the Department's ability to remove or modify a restriction on its own initiative, and the lapse or denial of an application for a change in ownership. Other areas covered by the rule include service and effectiveness of the Department's decision on an application and the applicant's ability to file a written request for a review of the Department's decision with the NAC.

FINRA is proposing to revise NASD Rule 1017 as proposed Rule 1131 described below.

#### **1. Streamlining Amendments**

##### **▶ Redesignation and Consolidation of Procedural Elements in NASD Rule 1017 to Proposed Rule 1112**

FINRA is proposing to limit proposed Rule 1131 to the CMA process by deleting procedural elements of the CMA review process that either duplicate or closely parallel those elements that exist in the NMA process. Common elements include the procedures for application rejection, the request for additional documents or information, application withdrawal, application lapse and the membership interview. FINRA is proposing to consolidate these aspects of the application review process in proposed Rule 1112 as described above.

##### **▶ Submission of One Application for an Event Affecting Two or More Members<sup>32</sup>**

With some frequency, two or more member firms are involved in the same event requiring a CMA. In an effort to bring more efficiency to the review process for CMAs, FINRA is proposing to add a new provision under proposed Rule 1131(a) that would provide the Department with the discretion to permit the filing of a single CMA where two or more members are involved in the same contemplated event. The filing of a single CMA would be subject to a single fee pursuant to Schedule A to the FINRA By-Laws.

#### **2. Events Requiring Submission of Application and Department Approval**

The criteria for a CMA appear under paragraphs (a) and (b) of NASD Rule 1017. FINRA is proposing to integrate these paragraphs, with amendments described below, in proposed Rule 1131(b).<sup>33</sup> In addition, FINRA is proposing to add headers to more easily discern among the various events requiring a CMA. The clarifying headers would include merger, acquisition, divestiture or transfer, change in capital structure, business expansion, material

change in business operations, and removal or modification of a membership agreement restriction. These headers describe events covered by NASD Rule 1017.<sup>34</sup>

Currently, NASD Rule 1017(a) specifies the changes in a member firm's ownership, control or business operations that require a CMA and Department approval. Specifically, the events that require a member firm to file a CMA and obtain Department approval thereon are:

- a merger of the member with another member, unless both members are members of the NYSE or the surviving entity will continue to be a member of the NYSE;
- a direct or indirect acquisition by the member of another member, unless the acquiring member is a member of the NYSE;
- direct or indirect acquisitions or transfers of 25 percent or more in the aggregate of the member's assets or any asset, business or line of operation that generates revenues composing 25 percent or more in the aggregate of the member's earnings measured on a rolling 36-month basis,<sup>35</sup> unless both the seller and acquirer are members of the NYSE;
- a change in the equity ownership or partnership capital of the member that results in one person or entity directly or indirectly owning or controlling 25 percent or more of the equity or partnership capital; or
- a material change in business operations as defined in NASD Rule 1011(k).

► **Elimination of Exclusion for NYSE Member Organizations<sup>36</sup>**

In the case of a merger, acquisition or transfer in which a NYSE member organization is involved, NASD Rule 1017(a) currently excludes such member organization from the requirement to file an application for approval of the specified event. FINRA is proposing to eliminate this exclusion on the basis that NYSE Regulation, Inc. no longer conducts its own review of such transactions. The proposed rule would require a member seeking to effect any of these events to file a CMA for the Department's review whether or not the other broker-dealer is a member of FINRA.

► **Addition of Event Requiring a CMA – Change in Control Person<sup>37</sup>**

FINRA is proposing to add a new event that would require the submission of a CMA for a change in control person because the Department has encountered with some frequency situations where a member has changed its control person without filing a CMA. Proposed Rule 1131(b)(5) would require a CMA for a direct or indirect change of a member's control person, other than the appointment or election of a natural person as a partner, officer, director, principal of the member, or any person occupying a similar status or performing similar function, in the normal course of business, regardless of whether the change resulted from a change in capital structure.

► **Additions to List of Activities Viewed as “Material Change in Business Operations”**

Currently, the term “material change in business operations,” defined in NASD Rule 1011(k) and referenced in NASD Rule 1017(a)(5), includes, but is not limited to, three categories of changes:

- removing or modifying a membership agreement restriction;
- market making, underwriting or acting as a dealer for the first time; and
- adding business activities that require a higher minimum net capital under SEA Rule 15c3-1.

Consistent with the prior proposals presented in *Notices 10-01* and *13-29*, FINRA is proposing to supplement this list to include a member engaging, for the first time, in settling or clearing of transactions for the member’s own business or for other broker-dealers, or carrying customer accounts.<sup>38</sup> FINRA is also proposing to require a member to submit a CMA for the Department’s approval before making a business change that would change its SEA Rule 15c3-3(k) exemptive status, which would effectively incorporate NASD Rule 3140 (Approval of Change in Exempt Status Under SEC Rule 15c3-3).<sup>39</sup>

► **Removal or Modification of a Membership Agreement Restriction**

Currently, the removal or modification of a membership agreement restriction is addressed under NASD Rule 1017(a)(5), which cross-references to NASD Rule 1011(k)’s definition of “material change in business operations.”<sup>40</sup> For clarity, FINRA is proposing to move NASD Rule 1011(k)(1)—removing or modifying a membership agreement restriction—to proposed Rule 1131(b)(8). FINRA believes that positioning this event as a separate subparagraph represents a more sensible presentation of the criteria requiring a CMA and Department approval thereon.

**3. Elimination of Timing of CMA Filings and Pre-approval of Changes**

NASD Rule 1017(c) sets forth three timing considerations for filing specified types of CMAs. The first timing consideration concerns whether a member is contemplating a change in ownership or control. NASD Rule 1017(c)(1) requires a member to file an application for approval of such change at least 30 days before the change is expected to occur. Occasionally, it may take the Department more than 30 days to complete its review of the application. In such case, the member may decide to proceed with the proposed change before the Department has completed its review. If the member elects to do so, then the Department may impose new interim restrictions on the member consistent with the standards set forth under NASD Rule 1014, pending final Department action. A member may encounter difficulty if it decides to proceed with the change when the Department determines that the application is in need of additional documents or information, or that the member must to reverse or unwind the effected change.



The second timing consideration under NASD Rule 1017(c)(2) involves whether a member is seeking to remove or modify a membership agreement restriction. In this case, the member may file the CMA at any time, but any existing restriction would remain in place until the Department has completed its review.

The third timing consideration under NASD Rule 1017(c)(3) pertains to whether a member is contemplating a material change in business operations. In such situation, the member may file a CMA at any time, but must wait for the Department's final determination, unless the Department and member agree otherwise.

► **Elimination of Timing Considerations**

FINRA is proposing to eliminate the timing considerations for filing a CMA depending upon the type of contemplated change or event because these varied timing considerations tend to generate confusion. FINRA believes that requiring a member to file an application before effecting any change specified in paragraph (b) under proposed Rule 1131 establishes more clarity and certainty in the process.

► **Pre-approval of Changes**

The purpose of interim restrictions is to protect investors. During the retrospective review, various stakeholders said that the nature and scope of interim restrictions were unclear or hampered real-time business decisions. In addition, interim restrictions may result in costly logistical impacts to the member should they require the member to reverse or unwind the transaction or event. Moreover, NASD Rule 1017 contains an incongruity in the way in which the Department handles the risks inherent in changes in ownership, control or business operations. For example, because of the potential risk to the investing public, a member cannot effect a material change in business operations before obtaining the Department's approval, but a member can effect a change in ownership or control while the Department processes the application. Given the inherent risks under both types of changes, FINRA believes that any change specified under proposed Rule 1131(b), including a change in ownership or control, should not be permitted until such time as the CMA has been approved by the Department. FINRA is proposing to eliminate NASD Rule 1017(c) in its entirety in order to bring more uniformity to the CMA review process.

**4. Permissible Events for Form CMA Waiver (Proposed Supplementary Material 1131.01)**

FINRA is proposing new supplementary material to set forth the circumstances under which the Department may consider waiving the CMA filing requirement.<sup>41</sup> The proposed supplementary material would describe the circumstances under which a member contemplating a change in capital structure or control person may request a waiver of the CMA filing requirement. Under the proposed provision, the Department may grant a member's request to waive the CMA filing requirement where the contemplated change does not make any material changes in the applicant's business activities, management,

supervision, assets or liabilities, and the applicant is only proposing a change in the: (1) applicant's legal structure (*e.g.*, changing from a corporation to a limited liability company) or (2) equity ownership, partnership capital or other ownership interest in an applicant held by a corporate legal structure that is due solely to a reorganization of ownership or control of the applicant within the corporate legal structure (*e.g.*, reorganizing only to add a holding company to the corporate legal structure's ownership or control chain of the applicant).

The proposed supplementary material would also provide that the Department may grant a member's request to waive the CMA filing requirement for an acquisition, or divestiture or transfer of 25 percent or more in the aggregate of the member's assets or any asset, business or line of business that generates revenues composing 25 percent or more in the aggregate of the member's earnings measured on a calendar-year basis for the three years preceding the event where the member is: (1) ceasing operations as a broker-dealer; (2) filing a Form BDW (Uniform Request for Broker-Dealer Withdrawal) with the SEC; and (3) neither the member nor any of its Associated Persons is the subject of any claim (including, but not limited to, arbitration awards, or pending or settled arbitration claims or litigation actions) that could be disadvantaged by the proposed transaction. In any instance where a claim against a member or any of its Associated Persons is awarded or settled, such claim will not be deemed satisfied for purposes of proposed Rule 1131 until all payments are satisfied in full including any payments to be made on behalf of the member by a third party, pursuant to an agreement among the parties. Under the proposed provision, a member would be required to seek a waiver in the manner prescribed under the materiality consultation process set forth under proposed Rule 1132.<sup>42</sup>

#### **B. Materiality Consultation (Proposed FINRA Rule 1132)**

A member is required to file a CMA when it plans to undergo an event specified under NASD Rule 1017 (*e.g.*, merger, acquisition, material change in business operations). Before taking this step, a member has the option of seeking guidance, or a materiality consultation, from the Department on whether or not such proposed change would require a CMA. The materiality consultation process is voluntary and no fee is assessed, and the Department has publicly shared guidelines about this process on [FINRA.org](http://FINRA.org).<sup>43</sup>

In general, a member initiates a materiality consultation with the Department by submitting a letter, requesting the Department's determination on whether a proposed change is material such that it requires the submission of a CMA. The characterization of a proposed change as material depends upon an assessment of all the relevant facts and circumstances. The Department may communicate with the member to obtain further information regarding the proposed change and its anticipated impact on the member. Where the Department determines that a proposed change is material, the Department will instruct the member to file a CMA if the member intends to proceed and will advise that effecting the change without approval would constitute a violation of NASD Rule 1017.

FINRA is proposing to further codify the materiality consultation process under proposed Rule 1132. The proposed rule would retain the voluntary nature of this process, except that it would mandate consultation where there is a request to waive the submission of a CMA under the circumstances in proposed Supplementary Material 1131.01 described above.<sup>44</sup> The proposed rule would also mandate a materiality consultation where an applicant seeks to engage in, for the first time, retail foreign currency exchange activities, variable life settlement sales to retail customers, options activities or municipal securities activities.<sup>45</sup> The proposed rule would set forth the Department's ability to, among other things, assess the nature and scope of the contemplated activity; the history of sales practice events and disciplinary history of the applicant and its Associated Persons; the impact on the member's supervisory and compliance structure, personnel and finances; and any other impact on investor protection raised by the contemplated activity.

### **C. Safe Harbor from the CMA Process (Proposed FINRA Rule 1133)**

While NASD Rule 1017 sets forth the events that require a CMA, NASD IM-1011-1 (Safe Harbor for Business Expansions) creates a safe harbor for three categories of business expansions that a member may undergo without filing a CMA. The permissible areas of business expansion under the safe harbor include the number of Associated Persons involved in sales, number of offices (registered or unregistered), and number of markets made,<sup>46</sup> with those expansions measured on a rolling 12-month basis. The safe harbor is unavailable to a member that has a membership agreement that contains a specific restriction as to one or more of those three areas of expansion or to a member that has a "disciplinary history" as defined in NASD IM-1011-1.<sup>47</sup>

FINRA is proposing to revise NASD IM-1011-1 as proposed Rule 1133. The proposed rule would retain the existing three areas of expansion and their corresponding thresholds, as well as the recordkeeping obligations for increases in personnel, offices and markets to determine whether they are within the safe harbor. The proposed rule would also continue to exclude a member from relying on this provision if such member has a defined "disciplinary history."

The proposed amendments would relocate the defined terms "disciplinary history"<sup>48</sup> and "Associated Person involved in sales" from NASD IM-1011-1 to proposed Rule 1111. The proposed amendments would adjust the way in which the expansions are measured from a rolling 12-month basis to a 12-month period preceding the event.<sup>49</sup> In addition, the proposed rule would modify the existing practice of prohibiting any expansion in the safe harbor areas if any one type of expansion was restricted, and instead permit a member to rely upon the safe harbor for those types of business expansions from which it is not restricted.<sup>50</sup>

## Standards for Approval of Application (Proposed FINRA Rule 1140 Series)

NASD Rule 1014 sets forth the standards for admission for an application, the process and timing for granting or denying an application, the timing and content requirements for the Department's decision and submission of a membership agreement, and the effectiveness of restrictions in the membership agreement. The Department evaluates both NMAs and CMAs to determine whether the applicant meets the 14 standards set forth in NASD Rule 1014(a)<sup>51</sup> and for that reason, FINRA is proposing to restructure NASD Rule 1014 for clarity by separating key milestones in the application review process into separate rules housed under the proposed Rule 1140 Series and Rule 1150 Series (Department Decision). The proposed Rule 1140 Series (and the Rule 1150 Series described below) would encompass rules applicable to NMAs and CMAs.

### A. General Provisions (Proposed FINRA Rule 1141)

FINRA is proposing to adopt proposed Rule 1141 to expressly state that all applications shall satisfy the standards set forth in proposed Rule 1142, but would permit an applicant to identify any standard that it believes is not applicable to the Department's review by providing a detailed written description of its rationale to the Department.<sup>52</sup> The Department would have the authority to make the final determination of the applicability of any standard, and the applicant would be bound by that determination. The proposed rule would also make clear that such determination would not represent final action on the application for purposes of an appeal under the proposed Rule 1160 Series.

### B. Standards (Proposed FINRA Rule 1142)

FINRA is proposing to revise standards for admission in NASD Rule 1014(a) as proposed Rule 1142. As discussed further below, FINRA is also proposing to revise the other remaining paragraphs in NASD Rule 1014 concerning the decision-making aspects of an application such as granting or denying an application, the presumption to deny an application, the effectiveness of a restriction, and the content, service and effectiveness of the Department's decision, as the proposed Rule 1150 Series.

NASD Rule 1014(a) provides that after considering the application, the membership interview, other information and documents, the public interest and the protection of investors, the Department must determine whether the applicant meets 14 standards for admission set forth below.

NASD Rule 1014 Standard	Description
<b>Standard 1</b>	Complete and Accurate Application (Overview of the Applicant)
<b>Standard 2</b>	Licenses and Registrations Required by State and Federal Authorities and Self-Regulatory Organizations
<b>Standard 3</b>	Compliance with Industry Rules, Regulations, and Laws
<b>Standard 4</b>	Contractual or Other Arrangements and Business Relationships
<b>Standard 5</b>	Business Facilities
<b>Standard 6</b>	Adequacy of Communications and Operational Systems
<b>Standard 7</b>	Determining the Adequacy of Net Capital
<b>Standard 8</b>	Financial Controls
<b>Standard 9</b>	Control Mechanisms Consistent with Industry Practices
<b>Standard 10</b>	Adequate Supervisory System
<b>Standard 11</b>	Recordkeeping System
<b>Standard 12</b>	Continuing Education
<b>Standard 13</b>	Other Information Possessed by FINRA
<b>Standard 14</b>	Consistency with Federal Securities Laws

FINRA is proposing to streamline the standards under proposed Rule 1142 by deleting those that are obsolete and redundant, and consolidating others with the standards that are closely related. This streamlining effort would result in the reduction of the total number of standards from 14 to 10.

► **Consolidation of Standards 1 and 14 – Complete and Accurate Application**

Standard 1 requires that an application and all supporting documentation are complete and accurate. Standard 14 requires that an application and all supporting documents are consistent with applicable securities laws and regulations, and with applicable FINRA rules. FINRA is proposing to consolidate Standard 14 into Standard 1 to require that an application and all supporting documents are complete, accurate, and consistent with the federal securities laws, the rules and regulations thereunder, and FINRA rules.<sup>53</sup>

► **Consolidation of Standards 2 and 12 – Licenses and Registrations, and Continuing Education**

Standard 2 requires that an applicant and its Associated Persons have all licenses and registrations required by state and federal authorities and self-regulatory organizations (SROs). Standard 12 requires that an applicant has completed a training needs assessment and has a written continuing education plan.

FINRA is proposing to consolidate Standard 12 into Standard 2 because both standards pertain to registration and qualification. The proposed standard would also include the requirement that the applicant and its Associated Persons have paid all applicable fees.<sup>54</sup>

► **Consolidation of Standards 7 and 8 – Financial and Operational Controls; Capital; and Clarification of Criteria**

Under Standard 7, an applicant must meet the provisions set forth under SEA Rule 15c3-1, the SEC's net capital rule. If necessary, the Department may impose a reasonably determined higher net capital requirement beyond the minimum requirement after considering six specified factors. These factors include, among others, the applicant's ability to comply with SEA Rule 17a-11, the SEC's early warning rule, and meet expenses net of revenues for at least 12 months, based on reliable projections agreed to by the applicant and the Department. Under Standard 8, an applicant must have financial controls to ensure compliance with the federal securities laws, the rules and regulations thereunder, and FINRA rules.

FINRA is proposing to consolidate Standard 8 into Standard 7 because both standards pertain to an applicant's financial and operational responsibilities, and to amend the consolidated standard to clarify that an applicant's financial and operational controls comply with SEA Rules 15c3-1 and 15c3-3, and Rule 4110 (Capital Compliance).<sup>55</sup> In addition, FINRA is proposing to amend the consolidated standard to clarify that the Department may consider the amount of net capital sufficient to avoid early warning level reporting requirements, such as SEA Rule 17a-11 and Rule 4120 (Regulatory Notification and Business Curtailment), as applicable.<sup>56</sup>

Finally, FINRA is also proposing a clarifying amendment to Standard 7, deleting the phrase "net of revenues" to clarify the Department's current practice to consider the amount of capital necessary to meet expenses for at least 12 months based on reliable projections of revenue agreed to by the applicant and the Department.

► **Consolidation of Standards 9 and 10 – Supervisory System; and Clarification of Criteria**

Standard 9 requires that the applicant demonstrate that its compliance, supervisory, operational and internal control practices and standards are consistent with practices and standards regularly employed in the investment banking or securities business, taking into account the nature and scope of applicant's proposed business. Standard 10 requires the applicant to demonstrate that it has an adequate supervisory system, including written supervisory procedures, internal operating procedures (including operational and internal controls), and compliance procedures designed to prevent and detect, to the extent practicable, violations of federal securities laws and rules and regulations thereunder, and with applicable FINRA rules. In evaluating Standard 10, the Department is required to consider the overall nature and scope of the applicant's intended business operations and other specified factors that include, among others, whether each Associated Person

identified in the applicant's business plan to discharge a supervisory function has at least one year of direct experience or two years of related experience in the subject area to be supervised; whether the applicant will recommend securities to customers; and whether the applicant should be required to place one or more Associated Persons under heightened supervision pursuant to [Notice to Members 97-19](#).

FINRA is proposing to consolidate Standard 9 into Standard 10 because both standards pertain to an applicant's supervisory responsibilities,<sup>57</sup> and to amend some of the specified factors that the Department is required to consider under Standard 10 in the following ways. First, one of the factors concerns the requirement that an Associated Person have at least one year of direct experience and two years of related experience in the subject area to be supervised. FINRA is proposing to amend this factor to permit the applicant to identify that each Associated Person in the application is qualified, either by virtue or experience or training, to carry out his or her assigned responsibilities. This amendment would align with Rule 3110(a)(6), which specifies the minimum requirements for a member's supervisory system including "[t]he use of reasonable efforts to determine that all supervisory personnel are qualified, either by virtue of experience or training, to carry out their assigned responsibilities."

Second, another factor is whether the applicant will recommend securities to customers. FINRA is proposing to extend this factor to include whether the applicant will recommend transactions or investment strategies involving a security or securities to customers.<sup>58</sup> Finally, with respect to the factor concerning whether the applicant should be required to place Associated Persons on heightened supervision pursuant to [Notice to Members 97-19](#), FINRA is proposing to amend the standard to clarify that the Department will consider whether the applicant will implement heightened supervisory procedures on any Associated Person whose record reflects a history of industry or regulatory-related incidents, including one or more disciplinary actions or sales practice events.<sup>59</sup>

#### ► **Elimination of Standard 5 – Business Facilities**

Standard 5 requires an applicant to have adequate plans to obtain facilities that are sufficient to initiate the operations described in the applicant's business plan, considering the nature and scope of operations and the number of personnel, and comply with the federal securities laws, the rules and regulations thereunder, and FINRA rules. In reviewing NMAs and CMAs under this standard, the Department considers not only the obvious factors, such as office space and computer equipment, but also the location of such facilities to determine whether the applicant's business plan can be effected with adequate supervision of the applicant's business activities for compliance with all relevant securities rules. During the retrospective review, various stakeholders said that Standard 5 does not reflect modern business operations. For example, an applicant that does not have the traditional "bricks and mortar" presence because it operates through online electronic platforms would not clearly satisfy this standard. FINRA is proposing to delete this standard because it currently has little utility in the Department's review of an application.

► **Codification of Department Practice to Review Source of Funding**

FINRA is proposing to codify the Department's existing practice to evaluate whether direct and indirect funding sources present any regulatory concerns or may be derived from a person subject to a statutory disqualification. The proposed standard would require an applicant to fully disclose and establish through documentation all direct and indirect sources of funding.<sup>60</sup>

**C. Pending Qualifications for Associated Persons (Proposed Supplementary Material 1142.01)**

FINRA is proposing to add new Supplementary Material .01 to proposed Rule 1142. The proposed supplementary material would permit the Department, at its discretion, to approve a CMA where one or more Associated Persons have applied for, but not acquired, all licenses and registrations required by federal and state authorities, and SROs, subject to specified conditions. The conditions would include that all Associated Persons must acquire their required licenses and registrations within 90 days of the date of approval of the CMA; the applicant promptly notifies the Department when such licenses and registrations are acquired; the applicant does not engage in business activities that require a license or registration that has not been acquired; and if all required licenses and registrations are not acquired within the 90-day timeframe, the applicant must cease business operations until all such licenses and registrations have been acquired. FINRA believes that this proposed supplementary material would allow the Department to exercise its discretion, based on the facts and circumstances of the applicant and its Associated Persons, to provide some leeway to applicants for continuing membership and their Associated Persons to obtain the requisite licenses and registrations after the CMA has been approved. This proposed supplementary material would not apply to an applicant for new membership.

## Department Decision (Proposed FINRA Rule 1150 Series)

As noted above, FINRA is proposing to redesignate and amend, as the Rule 1150 Series, the other remaining paragraphs of NASD Rules 1014 concerning the decision-making aspects of an application, such as granting or denying of an application, the presumption to deny an application, the effectiveness of a restriction, the content, service and effectiveness of the Department's decision, and membership agreement. Moreover, NASD Rule 1017, which pertains to CMAs, includes similar concepts and language on the decision-making aspects of a CMA. FINRA believes that redesignating these provisions under a single set of rules would bring more clarity to the review process for both NMAs and CMAs.

**A. Timing of Decision (Proposed FINRA Rule 1151)**

NASD Rules 1014(c)(3) and 1017(h)(3) contain nearly identical language. Both provisions provide that if the Department fails to issue a written decision within 180 days after the filing of the application (new or continuing) or such later date as the Department and the applicant have agreed in writing, the applicant may file a written request with the FINRA



Board requesting that the FINRA Board direct the Department to serve a decision. Within seven days after the filing of such a request, the FINRA Board shall direct the Department to serve its written decision immediately or to show good cause for an extension of time. However, under NASD Rule 1014(c)(3), if the Department shows good cause for an extension of time, the FINRA Board may extend the 180-day time limit for issuing a decision on an NMA by not more than 90 days and under NASD Rule 1017(h)(3), the FINRA Board may extend the time limit for issuing a decision on a CMA by not more than 30 days.

FINRA is proposing to revise NASD Rules 1014(c)(3) and 1017(h)(3) as proposed Rule 1151. The proposed rule would adjust the timeframes by directing the Department to issue its written decision on an application within 150 days of the Application Filed Date (or such other date as the Department and the applicant have agreed to in writing) and retain the current seven-day timeframe in which the FINRA Board must direct the Department to serve a decision, and if the Department shows good cause for an extension of time, the FINRA Board may extend the 150-day time limit by not more than 90 days.

#### **B. Department Decision on Application (Proposed FINRA Rule 1152)**

##### **▶ Department Decision on Application and Effectiveness of Restriction**

NASD Rules 1014(b) and 1017(h) set forth the various decision outcomes on an application: the Department may grant the application in whole or in part subject to one or more restrictions, or deny the application. NASD Rule 1014(f) addresses the effectiveness of a restriction. FINRA is proposing to redesignate these provisions to paragraphs (a) and (b), respectively, under proposed Rule 1152. FINRA is also proposing to add a new provision under paragraph (a) to clarify that contingent upon the applicant's submission of an executed membership agreement, the Department's decision would become effective upon service and would remain in effect during an appeal under the proposed Rule 1160 Series.

##### **▶ Presumption to Deny Application**

NASD Rules 1014(b)(1) and 1017(h)(1) provide that the existence of specified events enumerated in Standard 3 (NASD Rule 1014(a)(3)) will create a rebuttable presumption to deny the application.<sup>61</sup> FINRA is proposing to redesignate and adopt these provisions, with no substantive changes, as proposed Rule 1152(c).<sup>62</sup>

#### **C. Content of Decision (Proposed FINRA Rule 1153)**

NASD Rules 1014(c)(2) and 1017(h)(2) set forth the content requirements of the Department's decision on an application. If the Department denies an application, NASD Rule 1014(c)(2) requires the Department to issue a decision that explains the reason for denial, referencing the applicable standard(s). Under NASD Rule 1014(c)(2), if the Department grants an application subject to restrictions, the Department's decision must explain in detail the reason for each restriction, referencing the applicable standard(s) upon which the restriction is based, and identify the specific financial, operational, supervisory, disciplinary, investor protection or other regulatory concern that the restriction is designed to address, and the manner in which the restriction is reasonably designed to address the

concern. Similarly, NASD Rule 1017(h)(2) provides that for a CMA that is granted or denied in whole or in part, the Department's decision must explain its reasons, referencing the applicable standard in NASD Rule 1014. FINRA is proposing to consolidate and adopt these provisions as proposed Rule 1153, and include a provision to address the Department's obligation to provide written notification to the applicant when the application is granted.<sup>63</sup>

#### **D. Submission of Executed Written Membership Agreement (Proposed FINRA Rule 1154)**

Currently, NASD Rules 1012(b), 1014(d) and 1017(h)(4) pertain to the submission of a membership agreement for NMAs and CMAs. Under NASD Rule 1012(b), if an applicant fails to file an executed membership agreement within 25 days after the Department serves the membership agreement (or within such other period agreed to by the Department and the applicant), the NMA or CMA will lapse. Under NASD Rule 1014(d), if the Department grants an NMA (with or without a restriction), the Department's final approval on the NMA is contingent upon the applicant's submission of an executed membership agreement pursuant to which the applicant agrees to abide by any restriction specified in the Department's decision, and obtain the Department's approval of a change in ownership, control or business operations under NASD Rule 1017. This contingency, however, is not present for a CMA. If the Department approves a CMA in whole or in part, NASD Rule 1017(h)(4) provides that the Department may require the applicant to submit an executed membership agreement.

To bring more clarity and uniformity to the submission of membership agreements, FINRA is proposing to consolidate and adopt these provisions, with amendments, as proposed Rule 1154. The amendments would require an applicant to submit an executed written membership agreement for an approved (with or without restrictions) NMA or CMA, and would shorten the timeframe in which the applicant must do so from 25 days to 15 days. The shorter timeframe would align with the general practice of applicants submitting their executed written membership agreements well within 25 days. Moreover, the proposed rule would clarify that upon submission of the membership agreement, the applicant may begin operating subject to the terms of such agreement.

#### **E. Service and Effectiveness of Decision; Final Action (Proposed FINRA Rule 1155)**

Currently, NASD Rules 1014(e) and 1017(i), which pertain to NMAs and CMAs, respectively, address the service and effectiveness of a decision on an application in nearly identical language. In an effort to bring more efficiency to the review process for the application review process, FINRA is proposing to consolidate and adopt these two provisions, with non-substantive changes, as proposed Rule 1155.

## Review of Department Decision (Proposed FINRA Rule 1160 Series)

Unlike disciplinary procedures, where FINRA determines when and if to initiate a proceeding, an applicant for new or continuing membership determines when to file an application, and when to initiate a proceeding with the NAC to review the Department's decision on an application.

In general, NASD Rule 1015 (Review by National Adjudicatory Council) permits an applicant to submit a request for review by the NAC of an adverse decision rendered on a NMA or CMA. NASD Rule 1016 (Discretionary Review by FINRA Board) also permits a Governor of the FINRA Board to call for discretionary review of a membership proceeding. Finally, a person aggrieved by final action of FINRA under the NASD Rule 1010 Series may apply to the SEC for appellate review. Collectively, these rules provide for the administration of MAP appeals. Among other things, these rules set forth specified time periods for holding hearings, satisfying document production requests, specify the evidence and testimony that may be considered, and identify information that the applicant must provide to FINRA.

As noted above, FINRA is proposing to incorporate within the proposed Rule 1160 Series, paragraphs (c) and (d) of NASD Rule 1012, which address ex parte communications and recusal or disqualification, respectively, and NASD Rules 1015, 1016 and 1019 (together, the MAP appeal rules). FINRA is also proposing to restructure these provisions by separating key milestones within NASD Rule 1015 into five distinct rules within the proposed Rule 1160 Series to present the MAP appeal process in a more sequential manner:

- ▶ Appeal to the NAC;
- ▶ Appointment and Powers of the Subcommittee; Recusal and Disqualification, or Withdrawal;
- ▶ Transmission of Record, Exhibit and Witness Lists; Withheld Documents;
- ▶ Hearing; and
- ▶ Recommended Decision of the Subcommittee and Decision of the NAC.

In addition, FINRA is proposing to amend the provisions to reflect current practices that would align, in large part, with the Rule 9000 Series (Code of Procedure), and update nomenclature to reflect usage consistent with the Rule 9000 Series.<sup>64</sup>

### A. Ex Parte Communications (Proposed FINRA Rule 1161)

Currently, NASD Rule 1012(c) pertains to ex parte communications with applicants or Interested FINRA Staff, and is derived from paragraphs (a) and (b) under Rule 9143 (Ex Parte Communications). FINRA is proposing to redesignate, with technical changes, NASD Rule 1012(c) to proposed Rule 1161. The technical changes would align with Rule 9143(a) and (b).

**B. Appeal to the National Adjudicatory Council (Proposed FINRA Rule 1162)**

FINRA is proposing to consolidate under proposed Rule 1162, the elements associated with initiating or ending the MAP appeal process by the aggrieved applicant by incorporating paragraphs (a) and (h) under Rule 1015, which pertain to the initiation, content of a request for review and abandonment of a request for review. In addition, FINRA is proposing to include within proposed Rule 1162 new provisions that would clarify the logistical aspects of initiating an appeal, such as directing where the applicant must file the notice of appeal and methods of service, the effect of an appeal and the applicant's ability to withdraw the notice of appeal.<sup>65</sup>

Currently, NASD Rule 1015(h) provides that if the applicant fails to specify the grounds for the appeal, appear at a hearing for which the applicant has notice, or file information or briefs as directed, the NAC or Subcommittee may dismiss the appeal as abandoned, and the Department decision shall become the final action of FINRA. FINRA is proposing to include other circumstances that would cause an appeal to be viewed as abandoned. Under the proposed provision, the other circumstances would include when an applicant files Form BDW, becomes expelled from FINRA membership or enters into liquidation proceedings under the Securities Investor Protection Act of 1970.

**C. Appointment and Powers of Subcommittee; Recusal and Disqualification, or Withdrawal (Proposed FINRA Rule 1163)**

Paragraph (d) of NASD Rule 1012 sets forth the procedures for the recusal or disqualification of a Governor or member of the NAC or Subcommittee. Paragraphs (d) and (e) of NASD Rule 1015 address the appointment and powers of the Subcommittee, respectively, and paragraph (g) pertains to the filing of additional information or briefs. FINRA is proposing to incorporate these provisions, with amendments, under proposed Rule 1163. The proposed amendments are described below.

**▶ Powers of Subcommittee**

FINRA is proposing to add new provisions to clarify the powers of the Subcommittee. Under the proposed rule, the Subcommittee may extend or shorten any time limits set forth in the Rule 1160 Series, and do all things necessary and appropriate to regulate the course of a proceeding including, but not limited to, resolving any and all procedural and evidentiary matters. In an effort to enhance procedural efficiency, FINRA is also proposing to add a new provision that would expressly require the applicant and the Department to participate in a scheduling conference at which the parties to the appeal may agree to a hearing date and the date for the Subcommittee to present its recommended decision to the NAC. The proposed rule would also permit the Subcommittee to cancel a previously scheduled hearing for good cause shown due to abandonment or other similar unreasonable unavailability of the applicant.<sup>66</sup>

► **Recusal and Disqualification, or Withdrawal**

As noted above, FINRA is proposing to redesignate NASD Rule 1012(d), which governs recusals or disqualifications, to proposed Rule 1163.<sup>67</sup> In addition, FINRA is proposing to add new provisions that would set forth the procedures for an applicant or the Department to move for disqualification of a member of the NAC or Subcommittee. This motion would be based upon a reasonable, good faith belief that a conflict of interest or bias exists or circumstances otherwise exist where the fairness of the member of the NAC or a Subcommittee thereof might reasonably be questioned. The proposed rule would also set forth a process for such member to withdraw from appointment should the member have a conflict of interest of bias, or circumstances otherwise exist where the fairness of the member might reasonably be questioned.<sup>68</sup>

**D. Transmission of Record, Exhibit and Witness Lists; Withheld Documents (Proposed FINRA Rule 1164)**

► **Transmission of Record, Exhibit and Witness Lists**

Paragraphs (b) and (f)(3) under NASD Rule 1015 govern the transmission of documents and the exchange of hearing exhibit and witness lists, respectively.

NASD Rule 1015(b) requires the Department to transmit the documents the Department considered in connection with the Department's decision and an index to the NAC and the applicant within 10 days after the filing of the request for review. FINRA is proposing to redesignate this provision, with amendments, to proposed Rule 1164. The proposed amendments would include lengthening the timeframe from 10 days to 21 days after the filing of the notice of appeal, which would align more closely with the timeframe under Rule 9321 (Transmission of Record), and specifying that such transmission is to be made electronically or in any other manner FINRA may prescribe.

NASD Rule 1015(f)(3) sets forth the time in which the parties on appeal must exchange their proposed hearing exhibits and witness lists.<sup>69</sup> Currently, such lists must be exchanged not later than five days before the hearing. FINRA is proposing to lengthen the time in which the parties must exchange their exhibit and witness lists from five days to 21 days before the hearing. In practice, five days is insufficient time to review these materials. Extending the timeframe to 21 days would afford the parties to the appeal and the Subcommittee a more reasonable amount of time to review exhibits and witness lists as well as afford the parties to the appeal more time to make objections to the proposed hearing exhibits or witnesses.<sup>70</sup> In addition, FINRA is proposing to add a new provision concerning expert witnesses. Under the proposed provision, at any time prior to the hearing, the Subcommittee or NAC, in the exercise of its discretion, may order the applicant and Department to disclose any expert witness and information related to the expert, including a statement of the expert's qualifications, a listing of other proceedings in which the expert has given expert testimony, a list of the expert's publications and copies of those publications.<sup>71</sup>

▶ **Withheld Documents**

FINRA is proposing to add a new provision to address the circumstances under which the Department may withhold documents and submit a list of documents withheld. This proposed new provision is derived from paragraphs (b) and (c) under Rule 9251 (Inspection and Copying of Documents in Possession of Staff), which addresses withheld documents and the list of withheld documents, respectively. FINRA believes that it would be prudent to include this provision to explicitly permit the Department to withhold a document from production under specified criteria. Criteria would include, among others, a document that is privileged or constitutes attorney work product, would reveal examination or investigative information, or is prohibited from disclosure by federal law. In addition, the amendment would include a provision governing the Subcommittee or NAC's authority to require the Department to submit a withheld document list, or submit to the Subcommittee or the NAC any document withheld. Upon review, the Subcommittee or the NAC may order the Department to make the list or any document withheld available to the other parties for inspection and copying unless federal law prohibits disclosure of the document or its existence. A motion to require the Department to produce a list of documents withheld would be based upon some reason to believe that a document is being withheld in violation of the proposed rule.

**E. Hearing (Proposed FINRA Rule 1165)**

Paragraphs (f)(1), (f)(2), (f)(3) and (f)(4) under NASD Rule 1015 set forth the hearing process, including the timing and notice of the hearing, the ability of the applicant and Department to be represented by counsel at the hearing, evidence and the hearing transcript, respectively. FINRA is proposing to redesignate these subparagraphs, with amendments, as proposed Rule 1165. As described below, the proposed amendments pertain to the time in which a hearing must be held, and evidence, and introduces a new provision concerning testimony.

▶ **Lengthening Time for Hearing to be Held from 45 Days to 90 Days**

Currently, NASD Rule 1015(f)(1) provides that a hearing must be held within 45 days after the filing of the request for review. In practice, this 45-day timeframe is difficult to meet, and in most cases, the hearing is held well after the 45-day timeframe. The proposed amendment to this provision would lengthen the time in which a hearing must be held from 45 days to 90 days. This expansion of time represents a more reasonable and practical approach to the appeal process for the parties involved. In addition, the proposed amendment would move away from paper-based methods of delivery of notice to an electronic process or in any other manner FINRA may prescribe.

▶ **Evidence**

As noted above, NASD Rule 1015(f)(3) provides in part, that the formal rules of evidence do not apply to a hearing before the NAC or Subcommittee. FINRA is proposing to redesignate the reference to the applicability of the formal rules of evidence in NASD Rule 1015(f)(3) to proposed Rule 1165 and add a new provision that would expressly provide that the

Subcommittee or NAC may exclude all evidence that is irrelevant, immaterial, unduly repetitious or prejudicial.<sup>72</sup>

In addition, FINRA is proposing to add a new provision that would expressly indicate that the Subcommittee or NAC's review would be limited to the documents and information the Department considered in connection with the Department's decision on the application, admitted exhibits submitted by the Department and the applicant in accordance with proposed Rule 1164, witness testimony, and any additional information or briefs the Department or applicant files as ordered by the Subcommittee or the NAC. The proposed new provision would also provide that other than the information specified above, any other evidence would be presumptively irrelevant, but that upon a showing of good cause by the parties to the appeal, the Subcommittee or NAC may admit other evidence presented by the parties to the appeal.

▶ **Testimony**

Currently, the MAP appeal rules do not address testimony given at a hearing. In order to address this gap in the hearing process, FINRA is proposing to include a new provision that would expressly provide that an applicant and its representative, and any other person subject to FINRA's jurisdiction must testify under oath or affirmation.<sup>73</sup>

**F. Recommended Decision of Subcommittee and Decision of National Adjudicatory Council (Proposed FINRA Rule 1166)**

Paragraphs (i) and (j) under NASD Rule 1015 pertain to the Subcommittee's recommended decision and the NAC's decision after considering the Subcommittee's recommended decision and all matters presented on appeal. FINRA is proposing to redesignate these two provisions, with amendments, as proposed Rule 1166.<sup>74</sup>

▶ **Lengthening Time in Which Subcommittee Must Present Recommended Decision to the NAC from 60 days to 75 Days**

Currently, NASD Rule 1015(i) provides that the Subcommittee's written recommended decision must be presented to the NAC within 60 days after the conclusion of the hearing. FINRA believes that 75 days reflects a more reasonable amount of time for the Subcommittee to make this presentation.

▶ **Adding "Remand" as a Disposition**

Currently, NASD Rule 1015(j)(2) provides that the NAC's decision must include, among others items, a statement on whether the Department's decision is affirmed, modified or reversed, and a rationale underlying the disposition, referencing the application standards under NASD Rule 1014(a). The proposed change would clarify that the NAC's decision may remand the Department's decision, while giving a rationale for the remand. Adding this disposition to the rule would align with the NAC's ability to remand the membership

proceeding currently set forth under NASD Rule 1015(j)(1), which describes the NAC's decision, and NASD Rule 1015(j)(3), which describes the issuance of the NAC's decision after the expiration of the call for review period.<sup>75</sup>

**G. Discretionary Review by FINRA Board (Proposed FINRA Rule 1167)**

FINRA is proposing to adopt NASD Rule 1016, with no substantive changes, as proposed Rule 1167.

**H. Application to SEC for Review (Proposed FINRA Rule 1168)**

FINRA is proposing to adopt NASD Rule 1019, with no substantive changes, as proposed Rule 1168.

## Other Proposed Amendments

**A. Amendment to Section 4(i) of Schedule A to the FINRA By-Laws**

Section 4(i)(3) of Schedule A to the FINRA By-Laws specifies the changes that may qualify for a waiver of the fee associated with filing a CMA. As described above, FINRA is proposing to recast the changes specified under Section 4(i)(3)(A)(i) and (ii) to proposed Rule 1131.01 (Permissible Events for Form CMA Waiver) as events that may qualify for a waiver from the CMA filing requirement.

Section 4(i)(3) also includes other examples of changes in ownership, control or business operations that may qualify a CMA for a fee waiver. Under Section 4(i)(3)(A)(iii) a CMA may qualify for a fee waiver where the proposed change does not make any day-to-day changes in the applicant's business activities, management, supervision, assets or liabilities, and the applicant is only proposing a change in the "percentage of ownership interest or partnership capital of an applicant's existing owners or partners resulting in an owner or partner owning or controlling 25 percent or more of the ownership interest or partnership and that owner or partner has no disclosure or disciplinary issues in the preceding five years[.]"

In addition, Section 4(i)(3)(B) provides that a CMA may qualify for a fee waiver where the proposed change is filed by an applicant in connection with a direct or indirect acquisition or transfer of 25 percent or more in the aggregate of the applicant's assets or any asset, business or line of operation that generates revenues composing 25 percent or more in the aggregate of the applicant's earnings measured on a rolling 36-month basis where the applicant also is ceasing operations as a broker-dealer (including filing a Form BDW with the SEC) and there are either:



- (i) no pending or unpaid settled customer related claims (including, but not limited to, pending or unpaid settled arbitration or litigation actions) against the applicant or any of its Associated Persons; or
- (ii) pending or unpaid settled customer related claims (including, but not limited to, pending or unpaid settled arbitration or litigation actions) against the applicant or its Associated Persons, but the applicant demonstrates in the CMA its ability to satisfy in full any unpaid customer related claim (*e.g.*, sufficient capital or escrow funds, proof of adequate insurance for customer related claims).

In addition to deleting Section 4(i)(3)(A)(i) and (ii) as they would be recast as proposed Rule 1131.01, FINRA is proposing to delete the remaining provisions under Section 4(i)(3), specifically Section 4(i)(3)(A)(iii) and Section 4(i)(3)(B), in their entirety. FINRA has found that in practice, such circumstances do not qualify a CMA for a fee waiver because of the Department's review of such situations is substantial.

#### **B. Deletion of Incorporated NYSE Rules and Related Interpretations**

FINRA is proposing to delete the following Incorporated NYSE rules and related rule interpretations as they are either redundant or obsolete:

- ▶ Incorporated NYSE Rule 311 (Formation and Approval of Member Organizations);
- ▶ Incorporated NYSE Rule Interpretation 311(f) (Principal Place of Business);
- ▶ Incorporated NYSE Rule Interpretation 311(g)/02 (Divisions of Member Organizations—Names);
- ▶ Incorporated NYSE Rule 312 (Changes Within Member Organizations);
- ▶ Incorporated NYSE Rule 313 (Submission of Partnership Articles—Submission of Corporate Documents); and
- ▶ Incorporated NYSE Rule 321 (Formation or Acquisition of Subsidiaries).

## **Economic Impact Assessment**

#### **A. Regulatory Need**

FINRA's retrospective review of the MAP rules, coupled with both internal and external stakeholder input, indicate that the current rules and their attendant processes may benefit from changes that would enhance their efficiency, and better achieve investor protection.

## B. Economic Baseline

The economic baseline for this proposal is the current set of MAP rules, and related guidance and Department practices. To obtain the Department's approval (in whole or part) of an application, an applicant must not only ensure that its application includes the necessary documents and information for the Department to undertake the review, but the applicant must also navigate a series of steps for the review process to proceed in a timely manner under either the regular timeframes described in the current rules or expedited (*i.e.*, Fast Track) timeframes, or risk the Department's rejection or lapse of the application. This proposal would affect all prospective (or new) member firms and existing (or continuing) member firms (and their Associated Persons).

### 1. Number of Submissions of NMAs, CMAs and Materiality Consultations by Year

As displayed in Figure 1 below, in 2017, the Department received 125 NMAs, 340 CMAs and 407 materiality consultations (known as "MatCons"). Over the past 10 years, from 2008 through 2017, the number of NMAs and CMAs the Department has received has decreased, but the number of MatCons the Department has received has increased. The decrease in the number of CMAs could be due to the increased use of MatCons.



Figure 1: Number of NMA, CMA and MatCon submissions received, on an annual basis, for the period 2008 through 2017.

In general, NMAs are submitted by small firms<sup>76</sup> or firms without any registered representatives. CMAs are submitted by firms of varying sizes. The number of CMAs submitted by large firms and mid-size firms has remained relatively flat over the past 10 years, and the number of CMAs submitted by small firms has declined. The number of MatCons submitted by large firms has remained relatively flat, number of submissions by mid-size firms has shown a small increase and number of submissions by small firms has shown a substantial increase over the same period. Based on these trends, it is likely that most of the costs and benefits associated with this proposal will accrue to small firms, which account for the majority of all submissions.

### 2. Department Processing Times

As displayed in Figure 2, the average processing time per submission for all three categories has decreased since 2013 following the introduction of the Fast Track review process. As described further below, the MAP Triage Program and the Fast Track review process have dramatically reduced processing times for all applications and MatCons. During the retrospective review, stakeholders had provided positive feedback on the Fast Track review process.

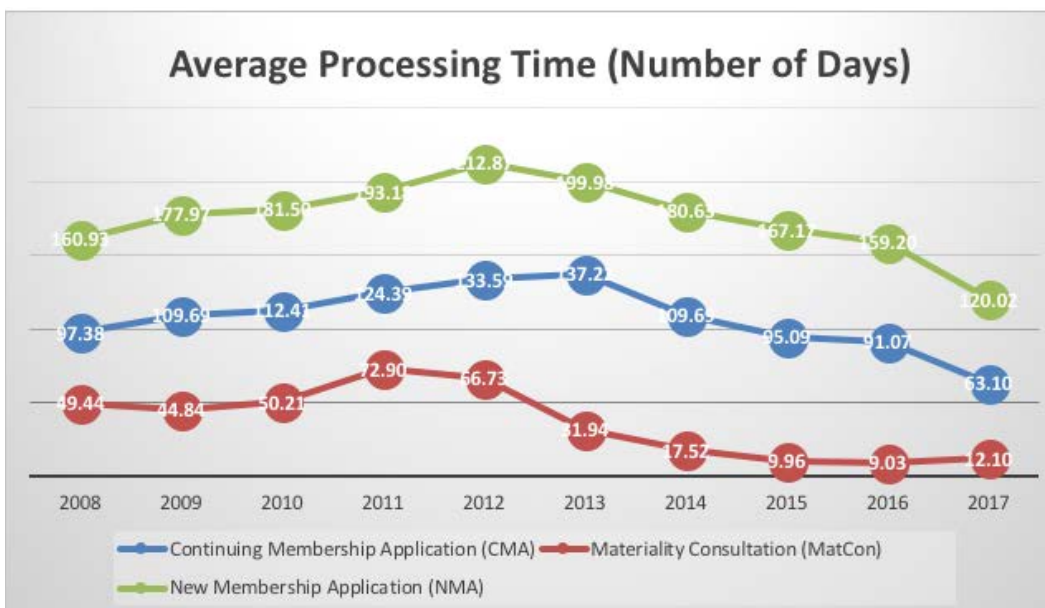


Figure 2: Average processing time of NMA, CMA and MatCon submissions, on an annual basis, for the period 2008 through 2017.

### 3. Costs of Compliance with Current MAP Rules and Processes

As part of the retrospective review, a survey sent to all FINRA members provided information about the economic impacts of complying with the current MAP rules and processes.<sup>77</sup> The costs of compliance included those associated with business interruptions, employing third-party resources (such as outside external professional assistance), internal expenses (such as staff hours, technology and other resources) and application fees. Most notably, the retrospective review revealed that for an NMA that underwent a full review, on average, the costs associated with employing third-party resources and internal costs each represented approximately 35 percent of the total compliance costs. About 20 percent of the costs were attributable to application fees and the remainder to indirect costs, such as business interruption. For an NMA that underwent an expedited review and a CMA that either underwent an expedited review or was subject to regular timeframes as described under the current rules, the greatest source of cost was associated with internal expenses, representing approximately 40 percent of the total compliance costs. For all applications, on average, the application fees accounted for approximately 20 to 33 percent of the total compliance costs.

### C. Economic Impacts

The proposed amendments to the MAP rules are designed to make them more concise through restructuring and streamlining, codifying existing guidance and Department practices, and updating terms consistent with other FINRA By-Laws and rules. FINRA believes that these proposed amendments will have a positive impact on the membership application and MatCon processes that will ease burdens on firms without materially diminishing investor protections.

#### 1. Restructuring and Streamlining the MAP Rules

The proposed restructuring and streamlining amendments to the MAP rules would lead to a more concise and efficient MAP process, updated to reflect technological advancements and changes in the industry, and will ultimately benefit the applicant firms, with a potential cost reduction to the investor community. An updated, streamlined set of the MAP rules and attendant processes would ultimately reduce costs for firms, including those associated with third-party resources. Lower direct costs to the application process that accrue to firms may benefit investors to the extent that firms may pass those cost-savings to them. While FINRA does not anticipate any increased risks to investors, periodic reviews of the new processes would help ensure that the changes are working as anticipated.

## 2. Proposed Codification of Existing Department Practices

Under the proposal, several existing Department practices would be incorporated into the MAP rules, which would positively impact the overall review period for applications and MatCons. Most notably, the proposal would reference the Department's discretion to determine whether an application may be eligible for expedited review and incorporate the MatCon process into the MAP rules.

### ► Initial Assessment and Expedited Review

FINRA is proposing to codify existing Department practices that would result in reducing the overall application review period from 180 days to 150 days. This 30-day reduction reflects the success of the MAP Triage Program. Under this Program, the Department conducts an initial assessment of the risk, complexity, regulatory significance, completeness, scale and scope of all applications and other MAP-related matters to determine whether the application or matter is eligible for expedited review, subject to shorter timeframes, or full review, subject to standard timeframes set forth under the MAP rules. During the retrospective review, stakeholders had viewed the expedited review process favorably, indicating that it effectively achieves its intended goal of identifying low-risk and low-complexity matters, and reducing processing times.

Since the program's launch in 2013, the overall processing times for applications and MatCons have decreased. As the program has matured, the number of applications and MatCons eligible for expedited review have significantly increased. As Figure 3 indicates below, in 2013, the number of NMAs, CMAs and MatCons that underwent expedited review was 5, 71 and 182, respectively. In 2017, the number of NMAs, CMAs and MatCons that underwent expedited review increased to 35, 189 and 358, respectively, representing 28 percent of the NMAs, 55 percent of the CMAs and 87 percent of MatCons submitted for Department review. The benefit of the expedited or Fast Track option is a better use of limited staff resources and more efficient handling of ex ante lower risk submissions. The program's impact on reducing the Department's overall review process is clear. As shown in Figure 2 above, in 2017, the overall processing timeframes for NMAs, CMAs and MatCons was 120 days, 63 days and 12 days, respectively.



Figure 3: Number of NMA, CMA and MatCon submissions eligible for Fast Track review, on an annual basis, for the period of 2008 through 2017.

After the Department considers various factors as described in proposed Rule 1112.01, an application may be eligible to undergo Fast Track review. As an option that is provided to the applicant, FINRA believes that a firm is likely to agree to the expedited processing if the incurred cost savings are deemed to be greater than the increased costs (*e.g.*, faster turnaround times for document requests) resulting from the expedited nature of the process. However, some firms may not want to expedite the application, as they will deem that such a process will not provide a net benefit and thus opt to go through the standard processing track. Shortening the timelines could potentially benefit the investor community by enabling the firms to provide services to their customers more quickly. As with the other efficiency improving process changes, risks to investors could arise from the expedited nature of the process, potentially leading to applications being approved that should not have been.

▶ **MatCon Process**

As described above, with a MatCon, a member has the option of seeking guidance from the Department on whether a proposed change in ownership, control or business operations would require a CMA. The MatCon process is voluntary and no fee is assessed, and guidance on this process appears on FINRA's website.<sup>78</sup> Because this process has existed for several years, FINRA expects that the economic impact that members may sustain as a result of codifying this process to be minimal. Currently, there is no fee assessed for this process, and this would remain so under the proposal. While the proposal would retain the voluntary nature of this process, it would mandate consultation in two instances where there is a request to waive the submission of a CMA under specified circumstances and when an applicant seeks to engage in a specified activity for the first time.<sup>79</sup> Even with these two instances mandating a member to submit to the MatCon process, the economic impact of codifying this practice would be minimal as members would not be assessed a fee for this option.

3. **Proposed Amendments to the MAP Rules Affecting the NMA and CMA Processes**

▶ **Definition of New Term, "Control"**

FINRA is proposing to define, for the first time, "control" to apply only to the MAP rules.<sup>80</sup> FINRA believes that the proposed definition would provide clarity to the control standards under the CMA process set forth under the proposed Rule 1130 Series described above. As the concept of control is entwined in several provisions of the MAP rules, the proposed definition would benefit firms in terms of the constraints and conditions relating to internal organizational structure. This would provide more transparency on the roles and ownership structures of the firms, which would provide additional monitoring capabilities and ultimately decrease potential risks to the investor community. It is possible that firms could strategically allocate ownership percentages to keep certain individuals from meeting the definition, possibly leading to increased risks to customers. However, to mitigate this potential risk, the Department will maintain discretion in defining an individual as a control person. Moreover, the Department will maintain its discretion in aggregating ownership interests when considering the designation of control and control persons, even in cases where Associated Persons meet the *de minimis* definition per interest.

▶ **Expansion of Definition of "Sales Practice Event"**

Consistent with the prior proposals presented in *Notices 10-01* and *13-29*, FINRA is proposing to amend the existing definition of "sales practice event" to include an applicant or Associated Person who is subject to a "statutory disqualification" as defined in SEA Section 3(a)(39). This proposed change would be in conjuncture with FINRA's separate initiative on high-risk brokers. FINRA believes that while this potentially imposes a burden on the applicant, it would enhance investor protections.

► **Application Rejection and Application Lapse**

Currently, the MAP rules specify the circumstances that will either preclude an applicant from proceeding with the application at the outset (via rejection) or cause the Department to cease its review of the application (via lapse).

With respect to the rejection of an application, FINRA is proposing to eliminate the concept of an application that is “not substantially complete” by shifting the focus to whether an application includes the documents or information necessary for the Department to commence a “meaningful review” and deem the application “filed” for purposes of rendering a decision. As described above, under the proposed rule, the Department would have 15 days in which to make this assessment and should the Department determine that the application is deficient, then the applicant would have five business days to cure the deficiency. The applicant’s failure to do so would result in a rejection of the application. Should the applicant wish to submit another application, it would be required to start the process anew thereby incurring additional time and expense.

With respect to a lapsed application, FINRA is proposing to expand the Department’s authority to cease reviewing (or lapse) an application where the applicant makes substantial changes to the application well into the review process.<sup>81</sup> The proposed amendment would give the Department the authority to stop reviewing an application where the applicant makes substantial changes to it. The proposed expansion of the Department’s authority to lapse an application is intended to discourage applicants from trying to manipulate the Department’s decision-making process towards approval by presenting insufficient or incomplete information with the application either at the outset of the review process or while it is well underway. Under the proposed amendment, if the Department views the circumstances as potentially causing the application to lapse, then the applicant would have five business days to remedy the situation. The applicant’s failure to do so would result in a lapse of the application and should the applicant wish to submit another application, it would be required to start the process anew thereby incurring additional time and expense.

The aim of these proposed amendments is to provide clarity on the circumstances that may impede the application review process and the consequences of the specified circumstances. While these amendments may result in reduced flexibility and potentially higher initial costs for certain applicants, FINRA believes that overall, these review process safeguards would result in a more efficient and timely process that would ultimately benefit both applicants and the Department in terms of resource allocation. These proposed amendments may also encourage applicants to provide more complete information at the outset of the application review process, which would foster a more efficient MAP process.



▶ **Standards for Approval of an Application**

The MAP rules currently set forth 14 standards for admission. FINRA is proposing amendments to the standards that would reduce the total number of standards to 10 by deleting those that are obsolete and redundant, and consolidating closely related standards. The proposed amendments would likely have some economic impact on applicants without adversely affecting investor protection. The consolidation and elimination of standards may reduce the amount of information collected by minimizing the potential for an applicant having to provide duplicative information without reducing the relevant information the Department would need to review the application against the standards. The proposal also provides the applicant an option to identify any standard that it determines is not applicable to the application, along with sufficient justification for this determination. In such situations, if approved, the applicant would benefit from the reduction in information and documentation required for application. In addition, FINRA is proposing to add a new standard that would codify the Department's existing practice to evaluate whether direct and indirect funding sources present any regulatory concerns such as funding that may be derived from a person subject to a statutory disqualification. Given that FINRA has already been requesting this information from submitting firms, this addition should have minimal impact on firms.

▶ **Amendments to the Membership Interview Procedures**

The proposed amendments will provide more flexibility in the number, timing and location of interviews that are required throughout the application process. The proposed amendments will further eliminate the tie between the conclusion of the interview and when the decision is due. FINRA believes that this will benefit the applicants in terms of potentially reducing the costs associated with the interview process, without incurring any risks to the investor community.

**4. Proposed Amendments to the MAP Rules Affecting the CMA Process**

▶ **Waiver of the CMA Filing Requirement**

FINRA is proposing to add a new provision that would describe the circumstances that may qualify for a waiver of the CMA filing requirement (*e.g.*, Form BDW, no material change in the operations of the member firm). The proposed provision would provide examples of scenarios that may qualify for a waiver from filing a CMA and provide clarity on the waiver process, providing firms more clarity regarding the CMA submission process and when a waiver could be appropriately requested. Moreover, the proposed amendments could lead to greater future utilization of the CMA waiver request process, which would reduce the costs and resources firms incur throughout the CMA process without material diminution of investor protections.

► **Pending Qualifications for Associated Persons**

FINRA is proposing to add a new provision to the MAP rules that would permit the Department, at its discretion, to approve a CMA where one or more Associated Persons have applied for, but not acquired, all licenses and registrations required by federal and state authorities, and SROs, subject to specified conditions.<sup>82</sup> This proposed provision would lend members some flexibility in obtaining the requisite licenses and registrations within 90 days of CMA approval.<sup>83</sup> However, this proposed new provision could increase risks to investors of utilizing the services of unlicensed or unregistered Associated Persons. Once the CMA is approved, there is risk that the unqualified Associated Persons could act in the capacity of a registered person during the pending period in violation of the proposed provision or that the Associated Persons fail to acquire the necessary licenses and registrations within the 90-day period.

**D. Alternatives Considered**

FINRA considered various suggestions in developing the proposal. The proposal reflects the changes that FINRA believes at this time to be the most appropriate for the reasons discussed herein.

► **Definition of “Affiliate”**

In *Notice 13-29*, FINRA had proposed defining, for the first time, the term “Affiliate” to mean: (1) A person that directly or indirectly controls an applicant (excluding natural persons that control an applicant solely in his or her role as a director, general partner, limited liability company, managing member or officer exercising executive responsibility (or having similar status or functions); or (2) An entity that is controlled by, or is under common control with, an applicant.<sup>84</sup> FINRA staff has determined to refrain from defining “Affiliate” in this proposal vis-à-vis the proposed definition of “control” and the proposed amendment to the definition of “Associated Person” to exclude a person with a *de minimis* ownership interest that does not otherwise control the applicant.

► **Standards for Approval of an Application**

Standard 3 requires that an applicant and its Associated Persons are capable of complying with federal securities laws, the rules and regulations thereunder, and FINRA rules, including observing high standards of commercial honor and just and equitable principles of trade. This standard specifies various factors that the Department must consider to determine whether the applicant and its Associated Persons meet this standard.

FINRA considered additional factors for the Department to consider including whether the applicant or a percentage of its Associated Persons had a history of sales practice events (as that term is defined under proposed Rule 1111). FINRA staff considered various percentage thresholds for such factor and their respective impact on firms. FINRA staff has determined to refrain from specifying additional factors in Standard 3 pending further development of other separate initiatives to strengthen controls on brokers with a history of significant past misconduct and to ensure greater accountability for firms that choose to employ high-risk brokers, and to incentivize payment of arbitration awards.<sup>85</sup>

## Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA specifically requests comment concerning the following issues.

1. What are the alternative approaches, other than the proposal, that FINRA should consider?
2. The proposal seeks to modify the NMA and CMA processes by, among other things, amending definitions and standards for granting or denying an application. Is there any potential uncertainty regarding the proposed definitions?
3. Do the proposed shortened timelines for different MAP processes, including the Fast Track option, increase the risk that an application is approved when it would not have been under the normal review? If yes, do you believe the higher risk unduly reduces investor protections? If so, are there ways to mitigate these risks?
4. The proposal allows for the conditional approval of a CMA where one or more Associated Persons have applied for, but not acquired, all required licenses and registrations. Does this conditional approval increase the risk of customer harm either by Associated Persons acting in a registered capacity during the window or by Associated Persons failing to acquire the licenses and registrations within the window? If so, do customers have adequate ability to seek redress? Are there ways to mitigate these risks?
5. What are the costs and benefits of the proposed provision to provide the Department discretion in lapsing applications, in addition to rejecting applications? What are the investor protection implications?
6. Are there other costs and benefits associated with the proposal that are not currently captured in the Economic Impact Assessment? If so, what are they? How likely are they to occur? How large or important are these economic impacts? Are there alternative approaches that would mitigate the costs or increase the benefits?

## Endnotes

1. Persons submitting comments are cautioned that FINRA does not redact or edit personal identifying information, such as names or email addresses, from comment submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the Federal Register. Certain limited types of proposed rule changes take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.
3. An applicant is required to submit its application for new or continuing membership using Form NMA or Form CMA, respectively. FINRA expects to make conforming amendments to the standardized forms.
4. FINRA has previously sought comment on prior proposals to amend the MAP rules. *See Regulatory Notices 10-01* (January 2010) (*Notice 10-01*) and *13-29* (September 2013) (*Notice 13-29*). Where applicable, the proposed amendments presented therein that have been carried over into this proposal are noted.
5. The term “stakeholder” is used to describe those entities, organizations and persons who may be impacted by or otherwise have an interest in the MAP rules and this proposal.
6. In 2013, the Department launched the MAP Triage Program to speed approval of non-complex applications. Under this program, the Department evaluates applications to determine whether the matter is eligible for expedited (or Fast Track) review, subject to shorter timeframes, or full review, subject to standard timeframes set forth under the MAP rules. During the retrospective review, stakeholders had provided positive feedback on the Fast Track review process, indicating that it effectively reduced processing times for low risk matters. In fact, the Triage Program and the Fast Track process have dramatically reduced processing times for all applications. In 2012, before the existence of the Triage Program and the Fast Track review process, the average processing time for an NMA was 213 days; in 2017, 117 days. For a CMA, the average processing time in 2012 was 134 days; in 2017, 61 days. In 2017, the average processing time for a CMA that underwent Fast Track review was 34 days. For a materiality consultation, the average processing time in 2012 was 67 days and in 2017, 11 days.
7. This definition of “Associated Person” only applies to the MAP rules. For other FINRA rules, the FINRA By-Laws definition of “associated person of a member” applies. FINRA By-Laws Article I(rr) defines a “person associated with a member” or “associated person of a member” as: “(1) a natural person who is registered or has applied for registration under the Rules of the Corporation; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the Corporation under these By-Laws or the Rules of the Corporation; and (3) for purposes of Rule 8210, any other person listed in Schedule A of Form BD of a member[.]”

8. These proposed amendments to the definition remain substantively unchanged from the language presented in *Notice 13-29* for public comment.
9. This term was first presented in *Notice 10-01*. In response to commenters' concerns, the term was revised and presented in *Notice 13-29* for comment. The proposed definition presented herein differs from the definition proposed in *Notice 13-29*.
10. See FINRA By-Laws, Art. I(h): "controlling' shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting stock, by contract or otherwise. A person who is the owner of 20% or more of the outstanding voting stock of any corporation, partnership, unincorporated association or other entity shall be presumed to have control of such entity, in the absence of proof by a preponderance of the evidence to the contrary. Notwithstanding the foregoing, a presumption of control shall not apply where such person holds voting stock, in good faith, as an agent, bank, broker, nominee, custodian or trustee for one or more owners who do not individually or as a group have control of such entity[.]"
11. Contained within Form BD (Uniform Application For Broker-Dealer Registration) is an "Explanation of Terms," which defines "control" as follows:
 

**CONTROL** – The power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any person that (i) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25% or more of a class of a voting security or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (iii) in the case of a partnership, has the right to receive upon dissolution, or has contributed, 25% or more of the capital, is presumed to control that company. (This definition is used solely for the purpose of Form BD.)

FINRA notes that the proposed factors establishing the presumption of control are well-established as they appear, in varying degrees of similarity, in other definitions of "control." See, e.g., Form U4's "Explanation of Terms" and the New York Stock Exchange (NYSE) and [NYSE American membership application](#) for FINRA member firms.
12. See also the "Explanation of Terms" for Form BD and Form BR (Uniform Branch Office Registration Form), each defining a "person" to mean "[a]n individual, partnership, corporation, trust, or other organization."
13. This proposed amendment remains unchanged from the language presented in *Notices 10-01* and *13-29* for public comment.
14. 15 U.S.C. 78c(a)(39).
15. This update would align with Article IV, Section 1(a) to the FINRA By-Laws which provides, in part, that an "Application for membership in [FINRA], properly signed by the applicant, shall be made to [FINRA] via electronic process or such other process as [FINRA] may prescribe[.]"
16. See Securities Exchange Act Release No. 43157 (August 15, 2000), 65 FR 51377 (August 23, 2000) (Order Approving File No. SR-NASD-99-67) (stating in part, "if an application is so deficient upon submission that the Department staff cannot begin processing (e.g., it is missing major components of the application, such as written supervisory procedures or a business plan), the Department staff may reject the application.").

17. The concept of “meaningful review” is not new. *See Notice to Members 00-73* (October 2000) (providing, “if an application is so deficient upon initial submission that the staff cannot begin conducting a meaningful review, then the staff may reject the application and deem it to not have been filed.”). *See also What to Expect After you Apply as a New Broker-Dealer Firm* (stating, “[a]n application is considered substantially complete if it provides sufficient information allowing the staff to conduct a meaningful review.”).
18. *See* NASD Rules 1014(c)(3) and 1017(h)(3).
19. For example, an applicant may add a business line or change key personnel as the review period is well underway or approaching completion.
20. *See* [The Membership Interview](#).
21. FINRA is proposing to delete subparagraphs (b)(5), (b)(6) and (b)(7) under NASD Rule 1013, which address topics pertaining to financial condition, the standards for admissions and other information, as these provisions would be addressed in the proposed supplementary material.
22. Rule 1210.01, which becomes effective on October 1, 2018, is the successor to NASD Rule 1021(e). *See* Securities Exchange Act Release No. 81098 (July 7, 2017), 82 FR 32419 (July 13, 2017) (Order Approving File No. SR-FINRA-2017-007). NASD Rule 1021(e)(1) currently requires that a member (new or existing), except a sole proprietorship, have a minimum of two registered principals with respect to each aspect of the member’s investment banking and securities business pursuant to the applicable provisions of NASD Rule 1022. NASD Rule 1021(e)(2) provides that, pursuant to the Rule 9600 Series, FINRA may waive the two-principal requirement in situations that indicate conclusively that only one person associated with an applicant for membership should be required to register as a principal. NASD Rule 1021(e)(3) provides that an applicant for membership, if the nature of its business so requires, must also have a Financial and Operations Principal (or an Introducing Broker-Dealer Financial and Operations Principal) and a Registered Options Principal.
23. *See* Standard 2 in Forms NMA and CMA.
24. *See supra* note 22. The Rule 9600 Series (Procedures for Exemptions) sets forth the procedures under which a member and its associated person(s) may seek exemptive relief from the rules enumerated in Rule 9610(a). Among those rules is NASD Rule 1021, which governs qualification examinations and waiver of requirements. Under Rule 9610, a member seeking relief from NASD Rule 1021 (or Rule 1210, effective on October 1, 2018) outside of the new or continuing membership process, is required to file a written application with the appropriate department or staff of FINRA. Such application must contain the information specified under Rule 9610(b).
25. Forms NMA and CMA direct the applicant to provide a detailed explanation that demonstrates the reason(s) for the exemption and a contingency plan for situations where the sole General Securities Principal becomes unavailable to carry out his or her responsibilities. The Forms include a place for an applicant to indicate whether it is seeking a waiver or seeking to maintain a waiver already in place of the two-principal requirement under NASD Rule 1021, the predecessor to Rule 1210.01.

26. The proposed rule would retain the language specifying that NYSE and NYSE American member organizations would be subject to the FINRA By-Laws and Schedules to the By-Laws, including Schedule A, the consolidated FINRA rules and the NYSE rules incorporated by FINRA, provided that their respective securities businesses are limited to floor-based activities, or routing away to other markets orders that were ancillary to their core NYSE or NYSE American floor business under NYSE Rule 70.40 or NYSE American Equities Rule 70.40, as applicable.
27. This proposed amendment remains substantively unchanged from the language presented in *Notice 13-29* for public comment.
28. NASD Rule 1013(a)(1) sets forth a detailed list of items that must be submitted with an NMA. These items include: Form NMA; Form BD; a fingerprint card; a new member assessment report; a business plan; list of Associated Persons; documentation of disciplinary history and certain regulatory, civil, and criminal actions, arbitrations, and customer complaints for the applicant and its Associated Persons; a description of remedial action or heightened supervision imposed on an Associated Person by a state or federal authority or SRO; a written acknowledgment that heightened supervisory procedures may be required for Associated Persons whose records reflect disciplinary actions or sales practice events; a copy of proposed or final contracts with banks, clearing entities, and service bureaus; a description of the nature and source of the applicant's capital; a description of financial controls; a description of the applicant's supervisory system; a description of the number, experience, and qualifications of supervisory personnel; a description of the proposed recordkeeping system; a copy of the applicant's written training plan; and FINRA entitlement forms. Many of these items are duplicated, in varying degrees, in the standards themselves or are referenced in the NMA (or Form NMA) itself.
29. The actions specified in proposed Rule 1123(a) are also set forth in guidance posted on FINRA.org. As set forth on the website, these actions are subject to review and processing by FINRA's Registration and Disclosure Department. See [How to Apply as a New Broker-Dealer Firm](#).
30. The proposal to delete the specific items to accompany an application is not without precedent. During the effort to adopt Form CMA, the SEC approved amendments to NASD Rule 1017(b) to delete references to the specific items to accompany a CMA. See Securities Exchange Act Release No. 67082 (May 31, 2012), 77 FR 33539 (June 6, 2012) (Notice of Filing of Amendment No. 1 and Order Approving File No. SR-FINRA-2012-018) (deleting references to a business plan, pro forma financials, organization chart and written supervisory procedures as they would be included as part of Form CMA).
31. See, e.g., Rule 1017(b)(2)(A) (providing that an application for approval of a change in ownership or control must include "the names of the new owners, their percentage of ownership, and the sources of their funding for the purchase and recapitalization of the member.").
32. This proposed amendment remains substantively unchanged from the language presented in *Notices 10-01* and *13-29* for public comment.
33. As a result of this integration, NASD Rule 1017(b) would be deleted in its entirety. FINRA intends to amend Form CMA to conform to the requirements specified under this provision.
34. See paragraphs (a)(1) through (a)(5), paragraphs (b)(2)(B) and (C), and paragraph (k) of NASD Rule 1017.

35. FINRA is also proposing to adjust the unit of measure used to review an acquisition, and divestiture or transfer from a rolling 36-month basis to a three-year period immediate preceding the event.
36. This proposed amendment remains substantively unchanged from the language presented in *Notices 10-01* and *13-29* for public comment.
37. This proposed provision remains substantively unchanged from the language presented in *Notice 13-29* for public comment.
38. In *Notice 10-01*, FINRA had proposed supplementing the term, “material change in business operations,” to include “settling or clearing transactions for the Applicant’s own business for the first time, settling or clearing transactions for other broker-dealers for the first time, carrying accounts of customers for the first time, or any change in exemptive status claimed under paragraph (k) of SEA Rule 15c3-3.” In *Notice 13-29*, FINRA had proposed supplementing this term to also include variable life settlement sales to retail customers and retail foreign currency exchange activities consistent with existing guidance. *See Regulatory Notice 09-42* (July 2009) (stating, “firms should be aware that expansion into business activities related to variable life settlements constitutes a material change in business operations under NASD Rule 1011(k). Therefore, before engaging in variable life settlements, a firm must first file a [CMA] and receive approval of this change in business operations under NASD Rule 1017.”); and *Regulatory Notice 08-66* (November 2008) (stating, “firms should also be aware that expansion into retail forex constitutes a material change in business operations under NASD Rule [1011(k)]. Therefore, before engaging in over-the-counter forex business, a firm must first file for and receive approval of change in business operations under NASD Rule 1017.”). However, FINRA believes that these activities, among others, would be better addressed in the materiality consultation process described below.
39. FINRA is proposing to delete NASD Rule 3140 in its entirety.
40. The removal or modification of a membership agreement restriction is also addressed in other paragraphs under NASD Rule 1017. FINRA is proposing to integrate these provisions under proposed Rule 1131(b). *See* NASD Rule 1017(b)(2)(B) (indicating that an application requesting the removal or modification of a membership agreement restriction must present facts showing that the circumstances that gave rise to the restriction have changed and state with specificity why the restriction should be modified or removed in light of the standards set forth in NASD Rule 1014 and the articulated rationale for the imposition of the restriction); NASD Rule 1017(c)(2) (providing, in part, that “[a] member may file an application to remove or modify a membership agreement restriction at any time.”); and NASD Rule 1017(k) (permitting the Department to modify or remove a restriction on its own initiative).
41. The concept of waiving the CMA filing requirement was presented in *Notice 10-01* for public comment. In response to comments, FINRA made some adjustments to the original proposal, which were presented in *Notice 13-29*. Among the changes was to add another circumstance that may qualify for a waiver of the CMA filing requirement. Upon the member’s written request, the Department would consider waiving the CMA filing requirement for a member that was proposing a change in the “percentage of ownership interest, [limited



- liability company] membership interest, or partnership capital of an Applicant's existing owners or partners resulting in an existing owner or partner owning or controlling 25 percent or more of the ownership interest or partnership and that owner or partner [had] no disclosure or disciplinary issues in the preceding five years." After further consideration, FINRA has found that in practice, this circumstance would require a CMA because such change has raised issues concerning, for example, registration and qualification of that existing owner or partner now owning or controlling 25 percent or more of the ownership interest.
42. As described below, FINRA is proposing to delete Sections 4(i)(3)(A)(i) and (ii) of Schedule A to the FINRA By-Laws.
  43. See [Overview of Materiality Consultation Process](#). See also *Notice to Members 00-73* (October 2000) (stating, in the context of determining whether, based upon all the facts and circumstances, a change that falls outside of the safe harbor limits is material, "[a] member may, but is not required to, contact the District Office to obtain guidance on this issue.") and NASD IM-1011 (stating, "[f]or any expansion beyond these [safe harbor] limits, a member should contact its district office prior to implementing the change to determine whether the proposed expansion requires an application under Rule 1017.>").
  44. In separate proposals, FINRA is proposing to mandate materiality consultations under additional circumstances. See [Regulatory Notice 18-06](#) (February 8, 2018) (requesting comment on proposed amendments to the MAP rules to incentivize payment of arbitration awards); and [Regulatory Notice 18-16](#) (April 30, 2018) (requesting comment on proposed rule amendments relating to high-risk brokers and the firms that employ them).
  45. See *supra* note 38.
  46. NASD IM-1011-1 defines "Associated Persons involved in sales" to include all associated persons, "whether or not registered, who are involved in sales activities with public customers, including sales assistants and cold callers, but excludes clerical, back office, and trading personnel who are not involved in sales activities." FINRA is proposing to redesignate this defined term, with non-substantive changes, to proposed Rule 1111.
  47. For purposes of NASD IM-1011-1, "disciplinary history" means "a finding of a violation by the member or a principal of the member in the past five years by the Securities and Exchange Commission, a self-regulatory organization, or a foreign financial regulatory authority of one or more of the following provisions (or a comparable foreign provision) or rules or regulations thereunder: violations of the types enumerated in Section 15(b)(4)(E) of the Securities Exchange Act of 1934; Section 15(c) of the Securities Exchange Act of 1934; Section 17(a) of the Securities Act of 1933; SEC Rules 10b-5 and 15g-1 through 15g-9; NASD Rules 2110 (only if the finding of a violation is for unauthorized trading, churning, conversion, material misrepresentations or omissions to a customer, front-running, trading ahead of research reports or excessive markups), 2120, 2310, 2330, 2440, 3010 (failure to supervise only), 3310, and 3330; and MSRB Rules G-19, G-30, and G-37(b) & (c)."
  48. The term "disciplinary history" would undergo technical changes to update rule cross-references.

49. This proposed amendment to the unit of measure would align with the methodology under NASD Rule 1017(b)(2)(C) (providing, “[i]f the application requests approval of an increase in Associated Persons involved in sales, offices, or markets made, the application shall set forth the increases in such areas during the preceding 12 months.”).
50. This proposed amendment remains substantively unchanged from the language presented in *Notice 13-29* for public comment.
51. See NASD Rules 1014(a) and 1017(h).
52. The concept underlying the proposed amendment was presented in *Notices 10-01* and *13-29* for public comment.
53. This proposed amendment remains unchanged from the language presented in *Notices 10-01* and *13-29* for public comment.
54. The proposed amendment concerning fees remains unchanged from the language presented in *Notices 10-01* and *13-29* for public comment.
55. This proposed amendment remains substantively unchanged from the language presented in *Notices 10-01* and *13-29* for public comment.
56. This proposed amendment remains substantively unchanged from the language presented in *Notices 10-01* and *13-29* for public comment.
57. In *Notices 10-01* and *13-29*, FINRA proposed to delete Standard 9.
58. This proposed amendment remains unchanged from the language presented in *Notice 13-29* for public comment.
59. See *Regulatory Notice 18-15* (Guidance on Implementing Effective Heightened Supervisory Procedures for Associated Persons with a History of Past Misconduct) (April 30, 2018).
60. This proposed new standard was previously presented in *Notices 10-01* and *13-29* for public comment. The proposed new standard was presented in *Notice 13-29* as “[t]he Applicant has fully disclosed and established through documentation satisfactory to FINRA all direct and indirect sources of its funding, and FINRA has determined that such sources of funding are otherwise consistent with the standards set forth in this Rule.” The proposed language herein is consistent with Funding Portal Rule 110(a)(10)(D) (providing, “[t]he FP Applicant has fully disclosed and established through documentation all direct and indirect sources of funding.”).
61. See NASD Rule 1014(a)(3)(A), (C), (D) and (E).
62. In a separate proposal, FINRA is proposing to amend NASD Rules 1014(a) and (b) to specify that a presumption of denial would exist if a new member applicant or its Associated Persons are subject to pending arbitration claims. This presumption of denial for pending arbitration claims would not apply to a continuing membership applicant. See *Regulatory Notice 18-06* (February 8, 2018) (requesting comment on proposed amendments to the MAP rules to incentivize payment of arbitration awards).
63. Currently, this obligation is set forth under NASD Rules 1014(c)(1) and 1017(h)(2).
64. Most notably, FINRA is proposing to replace “review” with “appeal” to more accurately align with that term as it is used in the Rule 9300 Series (Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review). FINRA is also proposing to delete NASD Rule 1015(c), which pertains to the use of a membership application docket because the Department no longer maintains such a docket.

65. These proposed provisions are derived, in part, from paragraphs (a), (b), and (f) of Rule 9311 (Appeal by Any Party; Cross-Appeal), which pertain to the time to file a notice of appeal, the effect of an appeal, and the withdrawal of a notice of appeal.
66. These proposed provisions are derived, in part, from paragraph (a) of Rule 9235 (Hearing Officer Authority) and paragraph (a) of Rule 9322 (Extensions of Time, Postponements, Adjournments).
67. This provision is akin to paragraphs (a) and (b) under Rule 9160 (Recusal or Disqualification).
68. These proposed provisions are derived, in part, from paragraphs (a) and (b) under Rule 9233 (Hearing Panel or Extended Hearing Panel: Recusal and Disqualification of Hearing Officers), which sets forth the process for a party to move for disqualification of a hearing officer.
69. NASD Rule 1015(f)(3) also expressly provides that the formal rules of evidence do not apply to MAP appeals. As described below, FINRA is proposing to redesignate the reference to the applicability of the formal rules of evidence to proposed Rule 1165 (Hearing).
70. The extended timeframe is derived from paragraph (d) under Rule 9251 (Inspection and Copying of Documents in Possession of Staff), which requires production of documentation to occur not later than 21 days after service of a respondent's answer to a complaint filed by FINRA in connection with a disciplinary proceeding. This 21-day timeframe relating to the production of documents is also present under other rules within the Rule 9000 Series such as Rules 9252 (Requests for Information), 9264 (Motion for Summary Disposition), and 9347 (Filing of Papers in National Adjudicatory Council Proceedings).
71. This provision is derived from subparagraph (a)(5) of Rule 9242 (Pre-hearing Submission).
72. The proposed criteria are derived from Rule 9263 (Evidence: Admissibility).
73. The proposed provision is derived from Rule 9262 (Testimony).
74. FINRA is proposing to redesignate paragraphs (j)(1), (j)(3), and (j)(4) under NASD Rule 1015 to proposed Rule 1166 with no material changes.
75. The proposed change would also align with Rule 9349 (National Adjudicatory Council Formal Consideration; Decision).
76. A small firm has at least one and no more than 150 registered persons; a mid-size firm has at least 151 and no more than 499 registered persons; and a large firm has 500 or more registered persons. *See* Article I of the FINRA By-Laws (defining the terms, "Small Firm," "Mid-Size Firm," and "Large Firm").
77. *See* [Retrospective Rule Review Report—Membership Application Rules and Processes](#) (March 2016).
78. *See supra* note 43 and the accompanying text.
79. *See supra* notes 38 and 44, and the accompanying text.
80. The term "control" is also defined in other FINRA rules. *See, e.g.*, Rules 2360 (Options), 5121 (Public Offerings of Securities with Conflicts of Interest), 5122 (Private Placements of Securities Issued by Members), and 6710 (Definitions).
81. *See supra* notes 18 and 19, and the accompanying text.

82. The conditions would include that all Associated Persons must acquire their required licenses and registrations within 90 days of the date of approval of the CMA; the applicant promptly notifies the Department when such licenses and registrations are acquired; the applicant does not engage in business activities that require a license or registration that has not been acquired; and if all required licenses and registrations are not acquired within the 90-day timeframe, the applicant must cease business operations until all such licenses and registrations have been acquired.
83. This proposed provision would not apply to an applicant for new membership.
84. FINRA had also previously proposed defining “affiliate,” in slightly different terms, in *Notice 10-01*.
85. See *Regulatory Notice 18-06* (February 8, 2018) (requesting comment on proposed amendments to the MAP rules to incentivize payment of arbitration awards), and *Regulatory Notice 18-16* (April 30, 2018) (requesting comment on proposed rule amendments relating to high-risk brokers and the firms that employ them).