Chapter 2

Broker-Dealer and Associated Person Registration

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§ 2:1 Overview

This chapter describes the process of registering a business entity as a broker-dealer with the Securities and Exchange Commission (SEC) and the appropriate state regulators, and obtaining the necessary memberships in self-regulatory organizations (SROs). The chapter presupposes that a determination has been made that the activity in which an entity proposes to engage (or perhaps is currently engaged in without registration) constitutes effecting, inducing, or attempting to induce securities transactions in a manner that requires registration as a broker-dealer under section 15(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).¹ Regulatory requirements will vary widely depending upon the specific types of broker-dealer activities in which an entity proposes to engage; thus the proposed scope of activities should be clearly defined at the outset.

For purposes of this chapter, it is also assumed that a decision has been made as to the form of business entity (corporation, general or limited partnership, limited liability company) that will house the

broker-dealer and its jurisdiction of organization. Although it remains possible for an individual to register as a sole proprietorship broker-dealer, it is rarely done.) These determinations may be influenced by numerous factors, such as the desired ownership and economic arrangements, tax considerations, the physical location of operations, etc., that are beyond the scope of this chapter. The choices made will in any event be of little consequence to the processes discussed herein.

Section 2:2 addresses the process of registering with the SEC. The SEC has largely deferred to the Financial Industry Regulatory Authority (FINRA) in the review of prospective broker-dealers, but application for registration with the SEC on Form BD is the crucial first step for new broker-dealers.

Section 2:3 describes the process of registering individual employees of a broker-dealer, including examination requirements, the uses of Forms U-4 and U-5, and the prohibition on “warehousing” registrations of personnel.

Section 2:4 considers the process of applying for membership in FINRA. Virtually all broker-dealers are required to become members of FINRA as well as to register with the SEC. The FINRA membership process involves a detailed, substantive review of all aspects of the proposed business.

Section 2:5 provides a brief overview of additional requirements that apply to applications for membership in a national securities exchange, with emphasis on the New York Stock Exchange (NYSE).

2. FINRA was created in July 2007 through the consolidation of the National Association of Securities Dealers, Inc. (NASD) with the member regulation, Enforcement, and arbitration functions of the New York Stock Exchange. For consistency, “FINRA” is used in this chapter to refer to the NASD in respect of events prior to the consolidation. FINRA administers the rules of the NASD and certain rules of the NYSE (which FINRA refers to as the “Incorporated NYSE Rules”). FINRA announced its intention to rationalize the two sets of rules in an Information Notice entitled “Rulebook Consolidation Process” (Mar. 12, 2008). The first phase of new consolidated FINRA Rules was approved by the SEC in August and September 2008, and took effect on December 15, 2008, FINRA Information Notice (Dec. 8, 2008). FINRA’s website includes rule conversion charts that show how new FINRA Rules relate to the NASD and/or Incorporated NYSE Rules that they replace, available at www.finra.org/Industry/Regulation/FINRARules/p085560. The process is ongoing. For example, in January 2010 the SEC approved three rules for the consolidated rulebook, effective April 19, 2010. See FINRA Regulatory Notice 10-10 (Feb. 1010). In the meantime, each rule that has not been converted continues to be identified as an NASD or NYSE rule. Publications predating the creation of FINRA will continue to be identified by their issuing SRO (e.g., NASD Notices to Members and NYSE Information Memoranda).
Finally, section 2:6 offers guidance with respect to state broker-dealer registration requirements. Broker-dealers still remain subject to registration at both the state and federal level, although many states provide exemptions from registration (for example, for strictly institutional business or for levels of other activity considered *de minimis*) that are not available at the federal level.

§ 2:2 SEC Registration Process

§ 2:2.1 Requirements in the Statute and Rules

Registration with the SEC is a necessary, but not a sufficient, condition for an entity to operate as a broker-dealer.\(^3\) Section 15(a)(1) of the Exchange Act makes it unlawful for any broker-dealer that is an entity (or a natural person not associated with a broker-dealer entity) to use the jurisdictional means to “effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is registered in accordance with subsection (b).”

The ellipsis in the preceding quotation excepts activity in certain kinds of securities from registration under section 15(b): exempted securities (U.S. government and municipal securities), commercial paper, bankers’ acceptances, and commercial bills. A broker-dealer whose business is strictly limited to one or more of these types of securities is not required to register under section 15(b), but care should be taken that its activities are not subject to other registration regimes.\(^4\)

[A] Application for Registration

Section 15(b) provides that registration is accomplished by filing with the SEC an application “in such form and containing such information and documents concerning such broker or dealer and any persons associated with such broker or dealer, as the Commission, by rule, may prescribe as necessary or appropriate in the public interest

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3. Each registered broker-dealer, with the sole exception of OTC derivatives dealers, is also required to become a member of an SRO. For a discussion of the requirement of SRO membership, see *infra* section 2:4. For a discussion on OTC derivatives dealers, see *infra* note 61.

4. For example, a broker-dealer that acts exclusively as a commercial paper dealer is not subject to federal registration, but a broker-dealer that engages in municipal securities transactions may be subject to registration as a municipal securities dealer under Exchange Act § 15B, and one that engages in U.S. government securities transactions may be subject to registration as a government securities broker or dealer under Exchange Act § 15C.
or for the protection of investors.” The SEC has adopted Rule 15b1-1 under this section, which instructs applicants for registration to file Form BD “in accordance with the instructions to the form.” Form BD is discussed in section 2:2.2.

Rule 15b1-1 further provides that all applications for registration must be filed with the Central Registration Depository (CRD) operated by FINRA. An application filed with the CRD is nonetheless, by operation of Rule 15b1-1(c), considered a “report” filed with the SEC for purposes of the Exchange Act. This means that sections 18(a) and 32(a) of the Exchange Act, which establish civil and criminal liability for false or misleading statements in reports, apply to Form BD.

[B] Grant or Denial of Registration

Section 15(b)(1) of the Exchange Act requires the SEC to act within forty-five days of the filing of the completed Form BD either by granting the registration or by instituting proceedings to determine whether the registration should be denied. In practice, the SEC will coordinate with FINRA and will grant its order of registration only when FINRA has indicated that it has approved the application for membership. However, the SEC is required to deny registration if it finds that circumstances exist that would cause the registration, if it were granted, to be subject to suspension or revocation. The circumstances under which the SEC might determine to suspend or revoke registration are enumerated in section 15(b)(4), although when those circumstances exist the SEC may, in the alternative, censure the firm or place limitations on its activities, functions or operations, or it may take no action if it finds that action is not required in the public interest. Nonetheless, because the circumstances in section 15(b)(4) are potentially fatal to an application for registration, they are worth summarizing here. The following relate to the entity applying for registration, its personnel, or both, as applicable: 5

- Willful false or misleading statements or omissions of material facts in required filings with the SEC or another domestic or foreign financial regulatory authority or in any proceeding before the SEC or a foreign financial regulatory authority with respect to registration.
- A felony or misdemeanor conviction within the preceding ten years involving securities transactions, false oaths or reports,

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5. The summary of § 15(b)(4) is intended to alert the reader to the types of circumstances that are of potential concern, but necessarily compresses and simplifies the list in the statute. Any questions identified in the course of preparing an application should of course be checked carefully against the statute and interpretations.
bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, misappropriation of funds or securities, or conspiracy to commit any of the foregoing, or involving the conduct of a financial services business.

- A permanent or temporary injunction by a court from acting as an investment adviser, underwriter, broker, dealer, or other regulated provider of financial services, or as an associated person thereof, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

- Willful violations of, or inability to comply with, any of the federal securities laws, the Commodity Exchange Act, or the rules or regulations under any of such statutes (including the rules of the Municipal Securities Rulemaking Board), or comparable foreign laws and regulations.

- The willful aiding or abetting of another person’s violation of any of the foregoing, or failure reasonably to supervise another person subject to supervision who commits such a violation.

- An SEC order barring or suspending the right of such person to be associated with a broker or dealer.

- A final order of a state securities, banking or insurance commission, or a federal banking agency (i) that bars association with financial services firms or engaging in financial services businesses, or (ii) that is based on violations of laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.

Specific information about any of these circumstances that may pertain to an applicant for registration is elicited in response to Form BD (in the case of entities) and Form U-4 (in the case of individuals), as discussed in sections 2:2.2 and 2:3 below.

[C] Registration of Security Futures Broker-Dealers

Security futures (that is, futures on a single security or on a narrow-based index of securities) were introduced by the Commodity Futures Modernization Act of 2000 (CFMA), which amended both the Exchange Act and the Commodity Exchange Act (CEA). Security futures are treated as securities for purposes of the Exchange Act, as amended by the CFMA but they may be traded on either securities exchanges or

7. See id. § 3(a)(10).
futures exchanges. To address this anomaly, the Exchange Act provides that existing futures exchanges that wish to trade security futures may register as a national securities exchange by filing a notice registration with the SEC,\(^8\) and that members of a futures association registered under section 17 of the CEA may make a notice filing with the SEC to register as a broker-dealer for the limited purpose of trading security futures on such an exchange.\(^9\) In each case, registration is effective upon submission of the notice. In addition, the Exchange Act provides that a futures association registered under section 17 of the CEA “shall be” a registered national securities association for the limited purpose of regulating the activities of their members who are registered as broker-dealers in security futures products.\(^10\) This provision is self-executing, no notice filing is required by a futures association. However, certain rule amendments relating to the trading of security futures products must be filed with the SEC.\(^11\)

[D] Six-Month Inspection

One final statutory provision relating to registration is worth noting before turning to Form BD. Section 15(b)(1)(C) requires the SEC or, at the SEC’s direction, an SRO of which a new broker-dealer is a member, to conduct an inspection of each new broker-dealer within six months after granting registration to determine whether the broker-dealer is operating in conformity with the Exchange Act and the rules thereunder. Rule 15b2-2 specifically directs a new broker-dealer’s SRO to conduct an inspection within that six-month period to determine whether the broker-dealer is operating in conformity with applicable financial responsibility rules (including Rules 15c3-1 and 15c3-3, and rules relating to the lending or hypothecation of customer securities and to recordkeeping), and within twelve months to determine whether it is operating in conformity with other applicable rules and statutory provisions.

§ 2:2.2 Form BD

Form BD is available on the SEC’s website.\(^12\) An initial application for registration is filed in paper format with the CRD. A paper original must also be submitted to FINRA along with “entitlement forms” in order for the applicant to gain access to FINRA’s electronic filing system including the Web CRD system, which must be used for all

\(^8\) Id. § 6(g).
\(^9\) Id. § 15(b)(11).
\(^10\) Id. § 15A(k).
\(^11\) Id. § 15A(k)(3).
\(^12\) See Form BD, available at www.sec.gov/about/forms/formbd.pdf.
subsequent amendments to Form BD. Amendments to Form BD are filed electronically via the Web CRD system. Form BD must be updated “promptly” when the information on file becomes inaccurate or incomplete for any reason. Certain information filed on Form BD, including disclosure items in response to Item 11, is made publicly available on FINRA’s website.

[A] **Items 1–13**

Items 1 through 5 of Form BD require basic information about an applicant for registration, including its name, address and contact information; form, place, and date of organization; SROs in which membership is being sought; states in which the broker-dealer will register; and whether the broker-dealer is succeeding to the business of another broker-dealer. Items 6, 7, 8, and 13 require information about the conduct of the broker-dealer’s business: does it provide custody or clearing services to other broker-dealers; does it introduce customers to another broker-dealer; does any other person keep the broker-dealer’s books and records or custody funds or securities of the broker-dealer or its customers; does the applicant engage in any futures business or other non-securities business? Item 12 requires identification of the specific types of business in which the firm will engage (for example, “exchange member engaged in floor activities,” “mutual fund underwriter or sponsor,” “municipal securities dealer”). Items 9 and 10 require information about persons in a control relationship with the broker-dealer. Details of responses to these items must be provided on Schedule D to Form BD.

Item 11 of Form BD requires disclosure of criminal, regulatory, and civil proceedings. The questions relate to the applicant and any of its “control affiliates.” In responding to Item 11, considerable care should be taken both to identify all control affiliates of the applicant

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13. See infra section 2:4.2. The documents required to gain electronic access are enumerated on FINRA’s How to Become a Member—Introduction Page, available at www.finra.org/Industry/Compliance/Registration/QualificationsExams/MemberFirms/HowtoBecomeaMember/.
14. See infra note 83 and accompanying text.
15. General Instruction A.2. to Form BD.
16. A definition of “control” for this purpose is provided in the instructions to Form BD under “Explanation of Terms.” A presumption of control arises for any person that has voting or dispositive power with respect to 25% or more of a class of voting securities.
17. A “control affiliate” is defined to include any individual or organization that directly or indirectly controls, is controlled by or is under common control with the applicant, including any current employees who perform executive duties or have senior policy making authority. Id.
and to obtain from each one a comprehensive response to the questions in Item 11. For each affirmative response, details must be provided on a Disclosure Reporting Page (DRP BD), the forms of which are included with Form BD.

[B] Schedules A, B, and C

Schedules A and B to Form BD require disclosure of direct and indirect owners and executive officers. Direct ownership must be reported if it constitutes 5% or more of a class of the broker-dealer’s voting securities or its capital; indirect ownership must be reported if it constitutes 25% or more of a class of a direct owner’s voting securities or its capital. Schedule C is used to amend Schedules A and B.

[C] Schedule D

Schedule D, as noted above, provides space for responses to various items of Form BD. One of these is Item 10A, which requires information about entities in a control relationship with the applicant that are engaged in the securities or investment advisory business. This list differs in two respects from the list of control affiliates required to respond to Item 11. First, Item 10A applies only to entities, whereas control affiliates include natural persons. Second, Item 10A applies only to entities engaged in the securities or investment advisory business, whereas Item 11 is not so limited.

[D] Schedule E

Schedule E was formerly used to report branch offices and other business locations of a broker-dealer. Although Schedule E continues to appear in the official text of Form BD, it has been superseded by Form BR, which is discussed in section 2:2.3 below.

§ 2:2.3 Form BR—Registration of Branch Offices

Form BR, the Uniform Branch Office Form, has been used since October 31, 2005, to register a broker-dealer’s branch offices. By replacing Schedule E of Form BD as well as branch office forms previously required by the NYSE and certain states, Form BR enables broker-dealers to register branch offices electronically with FINRA, NYSE, other SROs, and states through a single filing with the CRD. Form BR is available on FINRA’s website.¹⁸

FINRA’s definition of “branch office” was amended in September 2005, with effect from July 3, 2006. The amendment, and a concurrent amendment to the NYSE’s definition in Rule 342, conformed the definitions used by the two SROs.19 As amended, NASD Conduct Rule 3010(g)(2)(A) defines “branch office” as “any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, or is held out as such,” subject to several exclusions:

- locations established solely for customer service and/or back office functions, where no sales activities are conducted and that are not held out to the public as branch offices;
- certain locations that are an associated person’s primary residence;
- certain locations, other than a primary residence, used for securities business for less than thirty business days in any one calendar year;
- offices of convenience, where associated persons occasionally and exclusively by appointment meet with customers;
- locations used primarily for non-securities activities and from which no more than twenty-five securities transactions are effected in any one calendar year;
- the floor of a securities exchange where a member conducts a direct access business with public customers; and
- temporary locations established in response to the implementation of a business continuity plan.

Notwithstanding these exclusions, Conduct Rule 3010(g)(2)(B) provides that any location that is responsible for supervising the activities of associated persons at one or more non-branch locations is considered to be a branch office.

Branch offices that are “offices of supervisory jurisdiction” (OSJs) must be identified as such on Form BR. Under NASD Conduct

Rule 3010(g)(1), an OSJ is an office at which any of the following functions take place: order execution, market making, structuring of public offerings or private placements, custody of customers' funds or securities, approval of new accounts, review and endorsement of customer orders, final approval of advertising or sales literature, or supervision of activities at other business locations. Locations that conduct only final review of research reports are excepted from the definition of OSJ. In February 2007, FINRA solicited comments on a proposal to eliminate the defined term OSJ and adopt in its place definitions of the terms “supervisory branch office”; “limited supervisory branch office”; “non-supervisory branch office”; and “non-branch locations.” The rule amendments would also delineate the supervisory and inspection obligations that attach to each.\[20\]

\[\textbf{§ 2:2.4 SIPC}\]

The Securities Investor Protection Corporation (SIPC) is a nonprofit corporation created by, and for the purpose of administering, the Securities Investor Protection Act (SIPA), a federal statute that provides insurance for customers of brokerage firms to protect them against losses arising out of the financial difficulties of brokerage firms. SIPA also sets forth the manner of conduct for a liquidation proceeding for a broker-dealer facing insolvency. Most broker-dealers registered under section 15(b) of the Exchange Act are also required to be members of SIPC.\[22\]

Members of SIPC are assessed and liable for annual fees. The assessments are intended to be sufficient to maintain the SIPC fund, from which SIPC pays the cost of administration of the estates of broker-dealers in financial difficulty and pays to customers of failed broker-dealers the value of the cash and securities maintained in their accounts. The rate of assessment is periodically adjusted by SIPC.

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20. See FINRA Regulatory Notice 07-64 (Dec. 2007) (excepting locations that conduct only final review of research reports) and NASD Notice to Members 07-12 (Feb. 2007) (soliciting comment on proposed rule changes).


22. Broker-dealers whose functions are limited to the distribution of shares of mutual funds and unit investment trusts, sales of variable annuities, the business of insurance and the rendering of investment advice to registered investment companies and insurance company separate accounts are not required to be SIPC members. Also, broker-dealers whose principal business, taking into account the business of affiliated entities, is conducted outside the United States (including its territories and possessions) may be excluded from membership. SIPA § 3(a)(2).

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(Broker-Dealer Reg., Rel. #8, 5/10) 2–11
depending on the balance in the SIPC fund. The assessment, which had been a flat $150 per firm for many years, was raised to 0.25% of each firm’s net operating revenues on April 1, 2009. The increase was largely a result of substantial advances paid to former customers of Bernard L. Madoff Investment Securities LLC ("Madoff"), which was undergoing a SIPA liquidation. SIPC announced in October 2009 that its committed advances to Madoff customers totaled over $530 million, which exceeded the total of all advances made in the 321 prior liquidations handled since SIPC was organized in 1970.23

SIPC provides broker-dealers with appropriate membership forms after their registration with the SEC becomes effective.

§ 2:3 Registration of Personnel

§ 2:3.1 General

All individuals engaged in a broker-dealer’s securities business are subject to personal registration requirements under FINRA rules. An individual’s registration is specific to a broker-dealer. (In industry parlance, a specific broker-dealer “carries” an individual’s registration.) This means that the broker-dealer has accepted responsibility for supervising the individual. If an individual’s employer changes, the registration must be amended. If an individual is no longer associated with any broker-dealer, his or her registration lapses.

FINRA defines “person associated with a member” to include a natural person who is registered or has applied for registration; a sole proprietor, partner, officer, director, or branch manager of a member firm or a natural person occupying a similar status or performing a similar function; a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by the member firm, whether or not registered or exempt from registration; and, for purposes of investigations only, persons named on Schedule A to Form BD.24 In many cases there will be a substantial, if not total, overlap between a member firm’s registered personnel and its associated persons.


24. FINRA BY-LAWS art. I, § [rr]. Note that this definition, which for purposes other than investigations is limited to natural persons, differs from the definition of “person associated with a broker-dealer” in Exchange Act § 3(a)(18), which is not so limited. Note also, for purposes of FINRA’s Membership and Registration Rules [NASD Rules 1011–19], FINRA uses the more expansive definition of “associated person” found in NASD Membership and Registration Rule 1011(b), which includes certain entities. See infra section 2:4.2.
[A] Disqualification

A member firm must make an affirmative determination that an individual whose registration the firm intends to carry satisfies FINRA’s qualification requirements and is not subject to a “disqualification.” The term “disqualification” is defined in the By-Laws and is substantially similar to the list of circumstances under which the SEC may deny an application for registration as a broker-dealer, as described in section 2:2.1 above.

A member firm that wishes to register an individual who is subject to a disqualification, or to continue to carry the registration of an associated person who becomes subject to a disqualification, must file a written application to commence an eligibility proceeding. The series of rules beginning at FINRA Rule 9520 provide guidance on this process. Application is made on Form MC-400 and is filed with the CRD. A filing fee of $1,500 is required with the application, and an additional fee of $2,500 is required if the application leads to a full eligibility hearing. FINRA may, but is not required to, approve such an application if it determines that doing so is consistent with the public interest and the protection of investors, and any approval may be granted subject to terms and conditions that FINRA considers necessary or appropriate. One condition to be expected is that the individual will be subject to heightened supervision by the member firm.

§ 2:3.2 Categories of Registration

FINRA recognizes two broad categories of registration: representatives and principals. The term “representative” applies to persons...

26. FINRA BY-LAWS art. III, § 4. The definition was amended effective July 30, 2007 to incorporate the term “statutory disqualification” as defined in Exchange Act § 3(a)(39).
27. The definition, like the list of circumstances in Exchange Act § 15(b)(4), has application to both individuals and entities.
28. FINRA BY-LAWS art. III, § 3(d).
29. The form is available online as an exhibit to an SEC release relating to the Nasdaq Stock Market’s application for registration as a national securities exchange (Release No. 34-52559, Oct. 4, 2005, at Exhibit F, Tab 7). See Form MC-400, available at www.sec.gov/rules/other/nasdaqllcf1a4_5/f_formmc400.pdf. For certain disqualifications resulting from an injunction entered at least ten years prior to the application, a written request may be made instead of a formal application. NASD Procedural Rule 9522(e)(1).
30. FINRA BY-LAWS Schedule A, § 12.
31. FINRA BY-LAWS art. III, § 3(d).
32. See FINRA Procedural Rule 9523.
associated with a member “who are engaged in the investment banking or securities business for the member including the functions of supervision, solicitation or conduct of business in securities or who are engaged in the training of persons associated with a member for any of these functions.” The term “principal” applies to individuals “actively engaged in the management” of a member firm’s business, including those who are sole proprietors, officers, partners, managers of offices of supervisory jurisdiction, and directors of corporations.

Within the categories of representative and principal are subcategories that relate to the scope of an individual’s qualifications. For example, the broadest subcategory of representative is the General Securities Representative, which extends to most types of securities except options and security futures. There are also several subcategories of Limited Representative, which limit activities to the specified class of securities, such as Investment Company and Variable Contracts; Direct Participation Programs; Options and Security Futures; and Government Securities. Similarly, the broadest subcategory of principal is the General Securities Principal, but there are several subcategories of Limited Principal, such as Financial and Operations; Investment Company and Variable Contracts Products; and General Securities Sales Supervisor.

FINRA requires all member firms and all firms applying for membership (other than sole proprietorships) to have at least two registered principals with respect to each aspect of the firm’s investment banking and securities business. In general, applicants for membership must also have at least one principal who is qualified as a Limited Principal—Financial and Operations. In addition, NASD Rule 3012 requires each member firm to designate one or more

33. NASD Membership and Registration Rule 1031(b).
34. The term “office of supervisory jurisdiction” is defined in NASD Conduct Rule 3010(g). For a discussion of branch offices, see supra note 19 and accompanying text.
35. NASD Membership and Registration Rule 1021(b).
36. The full list of Limited Representative subcategories and their permitted activities is set forth in NASD Membership and Registration Rule 1032.
37. The full list of Limited Principal subcategories and their permitted activities is set forth in NASD Membership and Registration Rule 1022.
38. NASD Membership and Registration Rule 1021(e)(1). The rule was amended in 2003 to clarify that it applies to all existing members as well as applicants for membership. See NASD Notice to Members 03-20 (Apr. 2003).
39. NASD Membership and Registration Rules 1021(e)(3) and 1022(b)(1). A broker-dealer that does not carry customer accounts and that calculates its net capital ratio using the aggregate indebtedness standard is not subject to this requirement, but FINRA may nonetheless require such a firm to
principals to establish, maintain, and enforce a system of supervisory control policies and procedures. These principals must be senior to, or otherwise independent of, the personnel, including principals, whose activities they supervise.

Individuals associated with a FINRA member firm whose functions are solely and exclusively clerical or ministerial or who are not actively engaged in the investment banking or securities business are not required to be registered.40

§ 2:3.3 Qualification Examinations

Each category of registration is associated with a qualification examination, commonly referred to by a “series” number, that, with limited exceptions discussed below, must be passed before registration becomes effective.41 For example, the examination for a General Securities Representative is Series 7, and that for a Limited Representative—Investment Company and Variable Contracts is Series 6. Modified examinations are available for individuals who are currently registered and in good standing with the relevant securities authorities in the United Kingdom, Canada, and Japan.42 The examination for a General Securities Principal is Series 24, and that for a Limited Principal—Financial and Operations is Series 27. Passing an appropriate examination to be a representative is usually a prerequisite for taking an examination to be a principal. A complete list of examinations, along with study outlines, is available on FINRA’s website under the “Compliance” tab.

In 2009 FINRA adopted a new Limited Representative—Investment Banker registration category and the related Series 79 examination—required for individuals whose activities are limited to investment banking and principals who supervise such activities—effective from November 2, 2009. Those already registered as a General Securities Representative (Series 7) and engaged in a firm’s investment banking business were permitted to “opt in” to the new registration category by May 3, 2010.43


40. NASD Membership and Registration Rule 1060[a].
41. NASD Membership and Registration Rules 1032[a][1] (qualifying examinations for representatives) and 1022[a][1] (qualifying examinations for principals).
42. NASD Membership and Registration Rule 1032[a][2][B] (United Kingdom), [C] (Canada), and [D] (Japan).
43. See FINRA Regulatory Notice 09-41 (July 2009).
A qualification examination may be taken only under sponsorship of a member firm (or in some cases an applicant to become a member firm). An individual not associated with a member firm may not take an examination and (as discussed below) may not maintain an existing registration for more than two years. A person who fails an examination generally may not make another attempt until thirty calendar days after the date of the failed effort; failure three times in succession results in a bar from further examinations for 180 days.\(^{44}\) For the avoidance of doubt, FINRA’s rules specifically state that an applicant “cannot receive assistance while taking the examination.”\(^{45}\)

A person currently registered as a representative who proposes to assume the duties of a principal (under the auspices of his or her current employer or a different employer) is allowed a period of ninety days to pass the appropriate qualification examination for principals, during which time he or she may function as a principal.\(^{46}\)

A person previously registered as a representative or principal who has not been registered with a member firm for a period of two or more years (or whose registration has been revoked by FINRA) will be required to pass qualification examinations before he or she may again act as a representative or principal of a firm.\(^{47}\)

FINRA will grant a waiver of an examination requirement in “exceptional” cases.\(^{48}\) Waivers are available only for individuals who are able to demonstrate their qualification by other means, such as extensive experience in a field ancillary to the securities business or in the securities business in another country. Application for waiver must be made in writing in accordance with the procedures set out in FINRA Procedural Rules 9610 et seq.

In addition to the initial qualification examinations, all registered personnel are subject to the continuing education requirements set forth in NASD Rule 1120.

The broker-dealer registration requirements of many states provide that representatives who conduct a securities business in-state must pass the Uniform Securities Agent State Law Examination (Series 63). State registration requirements are discussed in section 2:6.

§ 2:3.4 **Forms U-4 and U-5**

Registration of individuals with FINRA is effected by filing Form U-4, the Uniform Application for Securities Industry Registration or

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44. NASD Membership and Registration Rule 1070(e).
45. NASD Membership and Registration Rule 1080.
46. NASD Membership and Registration Rule 1021(d).
47. NASD Membership and Registration Rules 1031(c) [as to representatives] and 1021(c) [as to principals].
48. NASD Membership and Registration Rule 1070(d).
Transfer. Form U-4 may be filed only by a FINRA member firm and must be filed electronically. However, each Form U-4 must be provided in paper format to the individual to whom it relates and that individual must sign it. The member firm must retain the signed Form U-4 and make it available upon regulatory request.\textsuperscript{49} Most of the information in an individual’s Form U-4 is not publicly available, although information about an individual’s employment history, registrations and Item 14 disclosure events (discussed below) may be obtained using the online BrokerCheck service, which may be accessed from FINRA’s home page by clicking on the “Investors” tab and then “FINRA Broker Check.”

Form U-4 is available on FINRA’s website.\textsuperscript{50} It requires detailed information about an applicant, including the individual’s physical characteristics, compliance with fingerprinting requirements,\textsuperscript{51} residential history (five years), employment and educational history (ten years), other businesses, and SRO registrations. Perhaps the most important part of Form U-4 is Item 14, which requires disclosure of criminal, regulatory, and civil proceedings; customer complaints; prior terminations of employment based on allegations of improper behavior; and personal financial disclosures including bankruptcy proceedings, denials, payments and revocations of bonds, and unsatisfied judgments. Any matter identified in Item 14 must be described on a separate Disclosure Reporting Page (DRP). A prospective employer, in reviewing a candidate’s Form U-4, should consider whether any affirmative responses to Item 14 constitute grounds for disqualification under the FINRA By-Laws.\textsuperscript{52}

The information in Form U-4 must be kept current by filing amendments. Like the initial filing by an employer, each amendment is a collaborative effort requiring the signature of the employee but filing and record keeping by the member firm.

Termination of employment is reported on Form U-5, the Uniform Termination Notice for Securities Industry Registration.\textsuperscript{53} Item 7 of Form U-5 requires an update of the disclosure questions in Item 14 of Form U-4. Form U-5 also requires disclosure of the nature of the

\textsuperscript{49} FINRA BY-LAWS art. V, § 2 and FINRA Member Application and Associated Person Registration Rule 1010(c).

\textsuperscript{50} FINRA provides a copy of Form U-4, available at www.finra.org/Industry/Compliance/Registration/CRD/FilingGuidance.

\textsuperscript{51} Fingerprinting requirements are set forth in Exchange Act Rule 17f-2 and FINRA Rule 1010(d).

\textsuperscript{52} For a discussion of disqualifications, see supra section 2:3.1[A].

\textsuperscript{53} FINRA provides a copy of Form U-5 and related instructions, available at www.finra.org/Industry/Compliance/Registration/CRD/FilingGuidance.
termination (for example, voluntary, permitted to resign, discharged) and, where the termination was not voluntary, the circumstances giving rise to it. If Form U-5 indicates that the individual is, or was at the time of termination, subject to an internal review for fraud, wrongful taking of property, or violating investment-related laws or rules or industry standards of conduct, the individual will have an opportunity to provide his or her own brief summary of the event on the appropriate DRP; in this case, the individual must also sign the Form U-5 with respect to that information. The information on Form U-5 is not publicly available.

Form U-5 states that, during the two-year period after termination of registration, the individual to whom the filing relates continues to be subject to the jurisdiction of regulators and must update it to reflect any changes of address during the period. Broker-dealers may be concerned about their liability for statements in Form U-5 about the grounds for termination. Courts in New York and California have ruled that employers are entitled to absolute privilege in respect of such defamation claims, whereas courts in most other states have found a qualified privilege or have not considered the question.

§ 2:3.5 Warehousing Prohibition

As discussed above, an individual’s registration must be carried by a broker-dealer, and an individual who has not been registered with a broker-dealer for two years or more will be required to take the appropriate qualification examinations in order to recommence employment in the securities industry. Frequently, an individual who has retired from active participation in the securities business, or who has changed careers, will request a former broker-dealer employer to continue to carry his or her registration, as a safeguard against having to retake an examination if circumstances change and the individual re-enters the securities business. This practice is specifically prohibited by FINRA. A member firm may not maintain the registration of any person who is no longer active in the firm’s securities business or is no longer functioning as a representative or principal, or where the sole purpose is to avoid the re-examination requirement after lapse of registration. Similarly, a member firm may not apply to register any

54. See Items 7B and 8B of the Form and Part II of the U-5 Internal Review DRP.
55. See Form U-5, Notice preceding Item 1.
57. See supra sections 2:3.1 and 2:3.3.
person “where there is no intent to employ such person in the member’s investment banking or securities business.”

§ 2:4 FINRA Membership Process

Section 15(b)(8) of the Exchange Act prohibits a registered broker-dealer from effecting securities transactions (other than on a national securities exchange of which it is a member) unless such broker-dealer is a member of a securities association registered under the Exchange Act. FINRA is for this purpose the only such registered securities association. Thus, a broker-dealer that intends to engage in any off-exchange securities transactions must become a member of FINRA. Moreover, a broker-dealer that is a member of the Nasdaq Stock Market (which became a national securities exchange in 2006) is required by Nasdaq Rule 1014(a)(15) to be a member of either FINRA or another national securities exchange.

58. NASD Membership and Registration Rules 1031(a) [as to representatives] and 1021(a) [as to principals]. The rules do permit registration of personnel who perform legal, compliance, internal audit, or back-office functions or who perform administrative support functions for registered personnel. Id.

59. Some broker-dealers limit their activities to market-making or specialist activity on one or more exchanges of which they are members. Historically, they have not been required to be members of the NASD because all of their activities are subject to the oversight of an exchange. However, when FINRA assumed the member regulation function of the NYSE in 2007, all NYSE-only firms were required to become FINRA members using a waive-in process. See FINRA Regulatory Notice 07-52 (Nov. 2007) and NASD Rule IM-1013-1.

60. As discussed in section 2:2.1 above, a futures association registered under § 17 of the CEA is a registered national securities association for the limited purpose of regulating the security futures activities of its members that are registered as broker-dealers in security futures products.

61. An exception is made in Rule 15b9-2 for limited-purpose broker-dealers known as “OTC derivatives dealers” under a regime popularly referred to as “broker-dealer lite.” However, most securities transactions by an OTC derivatives dealer are required to be intermediated by a fully regulated broker-dealer, which will be required by § 15(b)(8) to be a FINRA member. Exchange Act Rule 15a-1. See also OTC Derivatives Dealers, Exchange Act Release No. 40,594 (Oct. 23, 1998), at n.28 and accompanying text.

From 1965 to 1983, broker-dealers that traded only in the over-the-counter market were not required to join an SRO under the SEC Only or “SECO” program. However, the SEC found the direct assumption of SRO functions difficult to implement and recommended compulsory SRO membership in 1983. See Market 2000 Report: Study VI, Regulatory Structure and Costs (1994), at 21–22. This was accomplished by Pub. L. No. 98-38, 97 Stat. 206, effective Dec. 6, 1983, which enacted § 15(b)(8) in substantially its current form.
The process for joining FINRA is the most time-consuming and rigorous of the procedures necessary to commence operations as a broker-dealer. Prospective applicants should anticipate that the membership process, including the preparation of the application and supporting documents, will take a minimum of six months and possibly a year or longer. Fortunately, and in contrast to the process at some exchanges, the procedure is set forth in meticulous detail in FINRA’s rules. The discussion that follows summarizes the application process, which for the most part is set forth in NASD Rule 1013 et seq. It is recommended that this discussion be read in conjunction with the information on FINRA’s website regarding the membership application process. 62 Certain of the forms referenced below may be downloaded from FINRA’s website. FINRA also sells a membership kit that includes a CD with links to all necessary forms and explanatory information. 63

In Regulatory Notice 10-01 [Jan. 2010], FINRA proposed to its members for comment substantial revisions to the current NASD membership rules and certain NYSE membership rules, which would then be incorporated into the FINRA manual. The proposals had not at that time been approved by FINRA’s Board of Governors, or filed with or approved by the SEC. In view of the relatively early stage of the rulemaking process at press date, this discussion does not address the potential impact of the proposals.

As part of the membership process, each applicant must complete a new Member Assessment Report, which requires disclosure of all the applicant’s gross income received from over-the-counter, government, state, and municipal securities transactions in the preceding calendar year (or the fiscal year that ended in the preceding calendar year). 64 The disclosure required in this report can be problematic for applicants that have realized only belatedly that their activities may require registration as a broker-dealer. Counsel for such applicants should consider whether the level of securities activity during the period was sufficient to constitute a business 65 and, if so, whether the unregistered broker-dealer activity is likely to be prejudicial to the application.

62. See FINRA, How to Become a Member—Introduction, available at www.finra.org/Industry/Compliance/Registration/QualificationsExams/MemberFirms/HowtoBecomeaMember/index.htm.
63. Id. The cost of the kit is $24.95.
64. The form is available on FINRA’s website under “How to Become a Member” (see supra note 62). The information must be provided before deductions for salaries, wages, and other operating and overhead expenses.
65. The instructions to the form provide that “[i]f you were not conducting a securities business during such preceding period enter ‘NONE’ where appropriate.”
The disclosure is unavoidable unless the applicant is willing to suspend its securities activities and wait a year before applying for FINRA membership, which is likely to be impractical as a business matter.

Faced with the daunting task of organizing a broker-dealer and applying for FINRA membership, clients sometimes ask if it would not be easier to acquire the licenses of an existing broker-dealer. The question reflects a misunderstanding of the nature of FINRA membership. A firm’s FINRA membership is specific to the entity, its personnel, its lines of business, its capitalization, its ownership, and various other factors. Membership is a status rather than an asset, and it is not transferable except in limited circumstances involving successions and mergers. In this respect NASD membership must be distinguished from conventional membership (that is, a “seat”) on an exchange, which is an asset that, subject to numerous rule requirements, may be sold to the highest bidder. It is possible to purchase an entity that is a FINRA member, but any change of control is subject to thorough review by FINRA. If the purchaser of a member firm also seeks to expand the firm’s business operations into an area where the member was previously restricted, FINRA will review the change of control under the standards applicable to a new membership application.

§ 2:4.1  Name of Firm

In selecting a name for a broker-dealer, the list of members on FINRA’s website should be consulted. No member may have a name identical to the name of another member or a name so similar to another member’s “as to tend to confuse or mislead.” Any uncertainty as to whether a proposed name is too similar to an existing member’s name may be resolved by making written inquiry to FINRA’s Registration and Disclosure department. A name that is deemed acceptable will be reserved for ninety days.

§ 2:4.2  Membership Application

Applicants for FINRA membership must complete the FINRA’s New Member Application Form (Form NMA) and file it electronically.

66. See FINRA By-Laws art. IV, § 7.
67. See infra section 2:5.1.
68. NASD Membership and Registration Rule 1017.
69. NASD Membership and Registration Rule 1017(g)(1)(B).
70. NASD By-Laws art. IV, § 2[a].
71. Form NMA and the entitlement form necessary to obtain access to, and the ability to file, Form NMA are available on FINRA’s website under...
NASD Rule 1013 provides a detailed list of the materials that must be filed with an application. Form NMA is based on the list in Rule 1013. Perusal of either Form NMA or Rule 1013 will make it clear that an application should not be filed until the proposed operations of a broker-dealer have been carefully thought through. FINRA membership is particular to the proposed operations of the applicant. FINRA will not admit as a member a “blank check” broker-dealer.

For purposes of the membership process, the term “associated person” is defined in Rule 1011(b)72 to mean:

1. a natural person registered under NASD rules;
2. a sole proprietor, or any partner, officer, director, branch manager of the applicant, or any person occupying a similar status or performing similar functions;
3. any company, government, or political subdivision or agency or instrumentality of a government controlled by or controlling the applicant;
4. any employee of the applicant, except any person whose functions are solely clerical or ministerial;
5. any person directly or indirectly controlling the applicant whether or not such person is registered or exempt from registration under FINRA bylaws or NASD rules;
6. any person engaged in the investment banking or securities business controlled directly or indirectly by the applicant whether such person is registered or exempt from registration under FINRA bylaws or NASD rules; or
7. any person who will be or is anticipated to be a person described in (1) through (6) above.

The complete list from Rule 1013(a)(2) of materials required in an application follows, with explanatory footnotes added:

(A) Form NMA;
(B) an original signed and notarized paper Form BD, with applicable schedules;

72. This definition is more expansive than the general definition found in the NASD’s bylaws and discussed in supra section 2:3.1.
(C) an original FINRA-approved fingerprint card for each Associated Person who will be subject to SEC Rule 17f-2;\(^\text{73}\)

(D) a new member assessment report;\(^\text{74}\)

(E) a check for the appropriate fee;\(^\text{75}\)

(F) a detailed business plan that adequately and comprehensively describes all material aspects of the business that will be, or are reasonably anticipated to be, performed at and after the initiation of business operations, including future business expansion plans, if any, and includes:

(i) a trial balance, balance sheet, supporting schedules, and computation of net capital, each of which has been prepared as of a date that is within thirty days before the filing date of the application;

(ii) a monthly projection of income and expenses, with a supporting rationale, for the first twelve months of operations;

(iii) an organizational chart;

(iv) the intended location of the Applicant’s principal place of business and all other offices, if any, whether or not such offices would be required to be registered,\(^\text{76}\) and the names of the persons who will be in charge of each office;

(v) a list of the types of securities to be offered and sold and the types of retail or institutional customers to be solicited;

(vi) a description of the methods and media to be employed to develop a customer base and to offer and sell products and services to customers, including the use of the Internet, telephone solicitations, seminars, or mailings;

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73. Exchange Act Rule 17f-2 requires the fingerprinting of all partners, directors, officers, and employees of a broker-dealer, with limited exceptions for those who are not active in the sale or handling of securities, cash, or books and records and do not supervise any of such activities.

74. The new member assessment report is a form available from FINRA. This form elicits information about the applicant’s income from securities transactions in the year preceding the application. See text accompanying supra notes 64–65.

75. The basic fee is $5,000 for self-clearing firms and $3,000 for all others.

76. For a discussion regarding business locations that are not required to be registered with FINRA, see text accompanying supra note 19.
(vii) a description of the business facilities and a copy of any proposed or final lease;

(viii) the number of markets to be made, if any, the type and volatility of the products, and the anticipated maximum inventory positions;

(ix) any plan to enter into contractual commitments, such as underwritings or other securities-related activities;

(x) any plan to distribute or maintain securities products in proprietary positions, and the risks, volatility, degree of liquidity, and speculative nature of the products;

(xi) any other activity that the Applicant may engage in that reasonably could have a material impact on net capital within the first twelve months of business operations; and

(xii) a description of the communications and operational systems the Applicant will employ to conduct business with customers or other members and the plans and procedures the Applicant will employ to ensure business continuity, including: system capacity to handle the anticipated level of usage; contingency plans in the event of systems or other technological or communications problems or failures that may impede customer usage or firm order entry or execution; system redundancies; disaster recovery plans; system security; disclosures to be made to potential and existing customers who may use such systems; and supervisory or customer protection measures that may apply to customer use of, or access to, such systems;

(G) a copy of any decision or order by a federal or state authority or self-regulatory organization taking permanent or temporary adverse action with respect to a registration or licensing determination regarding the Applicant or an associated person;

(H) a list of all associated persons;\(^77\)

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\(^77\). For a discussion regarding associated persons, see *supra* note 72 and accompanying text.
documentation of any of the following events, unless the event has been reported to the Central Registration Depository:

(i) a regulatory action against or investigation of the Applicant or an associated person by the SEC, the Commodity Futures Trading Commission, a federal, state, or foreign regulatory agency, or a self-regulatory organization that is pending, adjudicated, or settled;

(ii) an investment-related civil action for damages or an injunction against the Applicant or an associated person that is pending, adjudicated, or settled;

(iii) an investment-related customer complaint or arbitration that is required to be reported on Form U-4;

(iv) a criminal action (other than a minor traffic violation) against the Applicant or an associated person that is pending, adjudicated, or that has resulted in a guilty or no contest plea; and

(v) a copy of any document evidencing a termination for cause or a permitted resignation after investigation of an alleged violation of a federal or state securities law, a rule or regulation thereunder, a self-regulatory organization rule, or an industry standard of conduct;

(J) a description of any remedial action, such as special training, continuing education requirements, or heightened supervision, imposed on an associated person by a state or federal authority or self-regulatory organization;\(^78\)

(K) a written acknowledgment that heightened supervisory procedures and special educational programs may be required pursuant to Notice to Members 97-19 for an associated person whose record reflects disciplinary actions or sales practice events;\(^79\)

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\(^78\) For a discussion regarding heightened supervision, see supra section 2:3.1[A].

a copy of final or proposed contracts with banks, clearing entities, or service bureaus, and a general description of any other final or proposed contracts;

a description of the nature and source of Applicant’s capital with supporting documentation, including a list of all persons or entities that have contributed or plan to contribute financing to the Applicant’s business, the terms and conditions of such financing arrangements, the risk to net capital presented by the Applicant’s proposed business activities, and any arrangement for additional capital should a business need arise;

da description of the financial controls to be employed by the Applicant;

da description of the Applicant’s supervisory system and a copy of its written supervisory procedures, internal operating procedures [including operational and internal controls], internal inspections plan, written approval process, and qualifications investigations required by Rule 3010;\(^{80}\)

da description of the number, experience, and qualifications of supervisors and principals and the number, experience, and qualifications of persons to be supervised by such personnel, the other responsibilities of the supervisors and principals with the Applicant, their full-time or part-time status, any business activities that the supervisors or principals may engage in outside of their association with the Applicant, the hours per week devoted to such activities, and an explanation of how a part-time supervisor or principal will be able to discharge his or her designated functions on a part-time basis;\(^{81}\)

da description of Applicant’s proposed record-keeping system;

da copy of the Applicant’s written training plan to comply with Firm Element continuing education requirements described in Rule 1120(b);\(^{82}\) including the name of the Associated Person responsible for implementation; and

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\(^{80}\) Supervisory requirements generally are addressed in Part II of this book. NASD Conduct Rule 3010 in particular is discussed in infra chapter 4.

\(^{81}\) As discussed in supra section 2:3.2, an applicant for FINRA membership [other than a sole proprietorship] must have at least two registered principals, at least one of whom generally must be a Limited Principal—Financial and Operations. NASD Membership and Registration Rule 1021(e).

\(^{82}\) Continuing education requirements are discussed in infra chapter 5.
a FINRA Entitlement Program Agreement and Terms of Use and a FINRA Member Firm Account Administrator Entitlement Form.\(^\text{83}\)

Some of the foregoing items, such as the Form BD, fingerprint cards, new member assessment report, and CRD entitlement forms may not be submitted electronically. Those items must be submitted to FINRA in paper format. The membership application fee must be paid electronically through the applicant’s CRD account. FINRA Regulatory Notice 08-14 explains that, after an applicant has funded its CRD account and has submitted all required paper-format documents, FINRA will provide access information necessary for submission of Form NMA and the other electronic components of the application.

[A] Fidelity Bonding Requirements

FINRA member firms also must carry a blanket fidelity bond that meets FINRA requirements as to form, amount, and type of coverage.\(^\text{84}\) NASD Rule 3020 requires that members carry a fidelity bond in an amount generally equal to at least 120% of their required minimum net capital,\(^\text{85}\) with a minimum bond of $25,000, to cover losses caused by the misconduct of officers and employees, including breaches of the duty of fidelity, misplacement or forgery of securities or other instruments, and fraudulent trading.

§ 2:4.3 Processing of Application

FINRA has thirty days from filing in which to review an application for completeness. Any application found to be not substantially complete will be rejected.\(^\text{86}\) If FINRA accepts an application, it may nonetheless request additional information during the initial thirty days after filing or at any time during the application process. An applicant is allowed up to sixty days to respond to an initial request,

83. These forms are available from FINRA. The Account Administrator Entitlement Form will enable the applicant to make all future CRD filings via the Internet-based Web CRD system. See NASD Membership and Registration Rule 1013(a)(2).

84. NASD Conduct Rule 3020. The fidelity bond requirement does not apply to firms that are not required to be a member of SIPC (see supra section 2:2.4 and note 22) or to firms that are members in good standing of a national securities exchange that imposes fidelity bond requirements.

85. NASD Conduct Rule 3020(a)(3) provides a schedule of fidelity bond amounts for broker-dealers with required net capital in excess of $600,000.

86. NASD Membership and Registration Rule 1013(a)(3). The application fee will be refunded, less a processing fee of $350.
Applications are reviewed under the detailed standards for admission set forth in Rule 1014[a]. These include (in addition to the completeness and accuracy of the application) consideration of the adequacy of the applicant’s financial controls, internal controls, compliance and supervisory procedures, record-keeping system, training program, communications and operational systems and its contractual arrangements with banks, clearing corporations, service organizations and others; the registration of its personnel, their ability to comply with federal securities laws and FINRA rules, and any past or pending disciplinary proceedings against any of the personnel; and the applicant’s ability to maintain adequate net capital. Ordinarily the staff of FINRA will work with an applicant to remedy any deficiencies in its application.

§ 2:4.4 Interview

One of the last steps of the application process is the pre-membership interview with the Department of Member Regulation. FINRA will identify the personnel who are expected to attend, who typically will include the principals responsible for the supervision of the firm’s activities and for preparing its financial statements. Each interviewee must have passed the appropriate qualifying examinations by the time of the interview. The applicant is required to prepare, for discussion at the interview, an updated trial balance, balance sheet, supporting schedules, and computation of net capital as of a date not more than forty-five days prior to the interview.

The interview is intended to address the firm’s business plans and to determine their adequacy and consistency with the federal securities laws and FINRA rules, good business practices in the securities business, a member’s fiduciary obligation to its customers, and the public interest and the protection of investors. An applicant for membership should expect to discuss in detail, among other things, the source of its capital and arrangements for additional capital; proposed record-keeping systems and other internal procedures; familiarity with the federal securities laws and FINRA regulations; arrangements with banks, clearing corporations, and others to assist it in the conduct of its securities business; and staffing and supervisory personnel and methods.

87. NASD Membership and Registration Rule 1013[a][4].
88. NASD Membership and Registration Rule 1013[b]. The interview will ordinarily be in the District Office in which the applicant has its principal place of business (as defined in Rule 1011[l]). FINRA provides a list of District Offices, available at www.finra.org/Industry/Contacts/index.htm.
89. NASD Membership and Registration Rule 1013[b][5].
FINRA quite naturally assigns considerable weight to an individual’s prior experience in the securities industry in evaluating his or her preparedness to act as a principal of a member firm. Individuals without prior experience as a principal should anticipate searching and detailed questions at an interview.\footnote{FINRA Membership and Registration Rule 1014(a)(10)(D) enumerates, as a consideration in evaluating the adequacy of an applicant’s supervisory system, whether each person identified in the 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. Although the rule clearly identifies this as a consideration, FINRA has elsewhere referred to these minimum levels as a “requirement.” See NASD Notice to Members 00-73 (Oct. 2000).}

\section*{§ 2:4.5 \underline{Decision and Appeals}}

FINRA will review the entire application, including the interview, in light of the standards for admission in Rule 1014.\footnote{See supra section 2:4.3.} Within thirty days after the interview, or, if additional information is requested, within thirty days of FINRA’s receipt of any additional information or documents requested by it, the applicant will be notified whether its application has been granted, denied, or granted subject to certain conditions placed on its business activities. Any such restrictions will be set forth in the applicant’s membership agreement.\footnote{FINRA has discontinued its earlier practice of placing the restrictions in a separate letter referred to as a “restrictions letter.”} The applicant must sign and return the membership agreement. If an application is denied, the specific reasons must be stated in the denial.

A member who objects to the restrictions imposed in its member agreement, or an applicant whose application is denied, may appeal to FINRA’s National Adjudicatory Council. Procedures for such an appeal are set forth in Rule 1015.\footnote{Additional guidance is provided in NASD Notice to Members 00-73 (Oct. 2000).} Appeal from the National Adjudicatory Council is made to FINRA’s Board of Governors, but only if one of the Governors calls for review.\footnote{NASD Membership and Registration Rule 1016.} Appeal of a decision by the Board of Governors is made to the SEC in accordance with section 19(d) of the Exchange Act.

\section*{§ 2:5 \underline{NYSE and Other National Securities Exchanges}}

A broker-dealer that is a member of FINRA and one or more national securities exchange is subject to the rules of each SRO. While some exchanges remain completely self-regulating, the trend among

\begin{footnotesize}
\footnote{FINRA Membership and Registration Rule 1014(a)(10)(D) enumerates, as a consideration in evaluating the adequacy of an applicant’s supervisory system, whether each person identified in the 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. Although the rule clearly identifies this as a consideration, FINRA has elsewhere referred to these minimum levels as a “requirement.” See NASD Notice to Members 00-73 (Oct. 2000).}
\footnote{See supra section 2:4.3.}
\footnote{FINRA has discontinued its earlier practice of placing the restrictions in a separate letter referred to as a “restrictions letter.”}
\footnote{Additional guidance is provided in NASD Notice to Members 00-73 (Oct. 2000).}
\footnote{NASD Membership and Registration Rule 1016.}
\end{footnotesize}
both newly formed and established exchanges appears to be to out-
source member firm regulation to FINRA. FINRA, which was formed
by the consolidation of the NASD with the member regulation,
enforcement, and arbitration functions of the NYSE in 2007, has
regulatory responsibilities for the Nasdaq Stock Market, NYSE Amex,
and the International Securities Exchange (ISE), as well as the NYSE.
NYSE’s former regulatory arm, NYSE Regulation, retains responsibil-
ity for market surveillance, related enforcement functions, and listed
company compliance.

Efforts to rationalize the inconsistent and duplicative rules of the
NASD and the NYSE pre-date the formation of FINRA. A review
announced by the NYSE in February 2006 resulted in formal proposals
for rule amendments in February 2007 (SR-NYSE-2007-22, referred to
below as the “NYSE Rule Harmonization Filing”). These proposals,
which were modified slightly in July 2007, were not acted upon by the
SEC. However, FINRA subsequently announced its intention to con-
tinue the rule harmonization project by consolidating the NASD rules
with the NYSE rules that it now administers (which FINRA refers to as
the “Incorporated NYSE Rules”) and, in the process and the process is
ongoing, eliminating obsolete and duplicative rules and harmonizing
those that are inconsistent [FINRA Information Notice dated March 12,
2008]. The first phase of this consolidation took effect in December
2008, and the process is ongoing, as discussed in supra note 1. It seems
likely that FINRA’s proposals for rules yet to be consolidated will be
informed by the NYSE’s proposals from 2007, and for that reason
certain aspects of the NYSE Rule Harmonization Filing have been
described in the following discussion of NYSE rules.

While the process for becoming a FINRA member is set forth in
reasonable detail in FINRA’s rules, the same is not generally the case
for national securities exchanges. For example, NYSE Rule 311(a)
provides that a person who proposes to form a member organization

shall notify the Exchange in writing before any such formation . . .
pay any applicable fee and shall submit such information as may
be required by the rules of the Exchange.

For an existing corporation, the rule requires certified lists of the
corporation’s security holders, members, directors, principal executive
officers, etc. The interpretive material under this rule requires an
“individually executed application” but does not indicate what infor-
mation is required in the application.95 The membership application
process also differs from exchange to exchange and even within
exchanges depending upon the member firm’s proposed activity.

95. NYSE Rule 311.11.
Fortunately, most exchanges have personnel who will assist applicants in the membership process and explain the requirements for each step. The purpose of this section, therefore, is not to describe the entire process of applying for exchange membership, but to alert prospective applicants to specific requirements that are different from or incremental to those of the FINRA membership process. This section focuses on the NYSE because its requirements tend to be the most comprehensive.

§ 2:5.1 Members and Member Organizations

Historically, exchanges drew a distinction between members (that is, natural persons who were the owners of the exchange and had the right to transact business on the floor of the exchange) and member organizations. Under this model, an entity that desires to become a member organization of an exchange must have at least one partner or employee who is a member. This creates a two-fold membership process: the individual must be approved as a member and the entity must be approved as a member organization.96

The traditional model began to break down as some exchanges, including the American Stock Exchange (now NYSE Amex LLC) in 1995 and the ISE in 2001, permitted memberships to be owned by member organizations rather than individuals associated with the organizations.97 The subsequent demutualization of the Pacific Exchange and, more recently, the NYSE, effected a complete separation of ownership from trading licenses. The Chicago Board Options Exchange (CBOE) filed a registration statement with the SEC in 2009 relating to a planned demutualization; however, at press date, the process had not been completed. Nasdaq, which became a national exchange in 2006, had been a publicly traded company since 2002 (although its structure was not originally mutual, having been owned by the NASD rather than by the broker-dealers that traded on it). Despite these developments, variants of the traditional model survive at some exchanges, and the model therefore must be understood by practitioners who represent members or prospective members of those exchanges.

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96. Individuals who are not members but who are engaged in a member organization’s securities business would also be subject to separate registration requirements.

97. See ISE Rule 100[a][23]. See also Chicago Board Options Exchange Const. art. I, § 1.1 and art. II, § 2.2; and Order Granting Approval to Proposed Rule Change Relating to Membership Structure, Exchange Act Release No. 35,723 (May 16, 1995).
In exchanges that are mutual organizations, a regular membership (or “seat”) is an ownership interest that includes distributive rights upon the winding up of the exchange. A member may own or lease a seat. Sales of seats are generally at auction, and the value of a seat may fluctuate significantly with market conditions. A seat may be owned by an individual or by a member firm which designates an individual as nominee to trade on its behalf on the floor.

A regular membership, or seat, is an asset of its owner that may be sold. The same is not true of a member organization’s membership. An organization’s exchange membership is similar to FINRA membership in that it is specific to the organization, is not an asset of the organization, and generally may not be transferred. The NYSE rules make this clear by describing an organization’s membership as a “revocable privilege.”

Applicants for individual membership are subject to numerous requirements. An applicant must pass the NYSE’s qualification examinations. In addition, the NYSE will generally require a signed personal statement describing the individual’s business history; a physical examination; at least three letters of recommendation; fingerprinting and a personal appearance before the committee considering the application. An applicant may also be subject to an “acceptability proceeding.” A CBOE applicant who completes all of these steps may finally be subject to a “posting” period, a notification process that affords other members the opportunity to voice any objections to the proposed admission of the member.

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98. E.g., CBOE Rule 3.14[a].
99. Prior to demutualization of the NYSE, in recognition that individual members often owned seats for the benefit of their associated member organization and did not wish to expose themselves to the risk fluctuations in value, NYSE Rule 301.14 permitted arrangements whereby the member organization assumed the risk of changes in value. These were referred to as “a-b-c agreements.”
100. See CBOE Rule 3.8.
101. See supra note 66 and accompanying text.
102. NYSE Rule 311[d].
103. NYSE Rule 304A[a].
104. NYSE Rule 301[b].
105. Id.
106. Id.
107. NYSE Rule 301[c].
108. NYSE Rule 301[d].
109. NYSE Rule 308.
110. CBOE Rule 3.9(e) (minimum ten-day posting period).
§ 2:5.2 Affiliated Persons and Entities

The SEC, in Form BD, and FINRA require disclosure concerning, and, in appropriate cases, registration of personnel who are associated with a broker-dealer, including directors (or the functional equivalent) and officers, as well as disclosure of direct and indirect owners of a broker-dealer. Exchange rules impose additional requirements on personnel involved in a broker-dealer’s business and also may require more detailed information about a broader category of affiliated entities and individuals.

[A] Control

As a threshold matter it is necessary to be familiar with the definition of “control” in NYSE Rule 2(e). This definition is similar, but not identical, to the definition that the SEC uses for purposes of Form BD. Under the NYSE rule, “control” means the power to direct or cause the direction of the management or policies of a person whether through ownership of securities, by contract or otherwise. This conceptual definition, however, is effectively overridden by three specific tests, any one of which is sufficient to establish a presumption of control. If none of those tests is met, a presumption of no control is established “and shall continue until a determination to the contrary has been made by the Exchange.” The presumption of control arises where a person, directly or indirectly,

(i) has the right to vote 25% or more of another person’s voting securities,

(ii) is entitled to receive 25% or more of another person’s net profits, or

(iii) is a director, general partner, or principal executive officer (or person occupying a similar status or performing similar functions) of another person.

[B] Allied Members; Principal Executives

The NYSE’s rules establish the category of “allied member” to encompass any individual who is not a member of the NYSE but is a general partner or principal executive officer of a member firm or an employee of a member firm who controls the member firm.111 The rules require any such individual to apply to become an allied member, a process less elaborate than that for becoming a member.112

111. NYSE Rule 304(b). See supra section 2:5.2[A].
112. Id.
The NYSE may require a candidate for allied membership to pass an examination, and an allied member must pledge to abide by the rules of the NYSE.\textsuperscript{113} These rules remain in the NYSE rule book as NYSE Incorporated Rules, but FINRA has stated that it does not recognize the category of allied member and will not accept applications for allied membership, as discussed below.

The NYSE Rule Harmonization Filing proposed to eliminate the concept of allied members and to replace the term in most locations in the NYSE Rules with the term “principal executives.” This approach was implemented in 2008 as part of the FINRA rule consolidation, except that the definition and qualification requirements for allied members were not altered. The term “principal executives” means individuals who “exercise senior principal executive responsibility over the various areas of the business of a corporation in such areas as the rules of the Exchange may prescribe, including: operations, compliance with rules and regulations of regulatory bodies, finances and credit, sales, underwriting, research and administration.”\textsuperscript{114}

\section*{[C] Approved Persons}

The NYSE has established the category of “approved person” to encompass any individual or entity that controls a member organization and any entity “engaged in a securities or kindred business”\textsuperscript{115} that is either controlled by or under common control with a member organization.\textsuperscript{116} As part of the membership application process, the NYSE requires a detailed worldwide organization chart for the applicant and its affiliates and a description of the business in which each affiliate engages. This process is relatively straightforward for a newly organized company owned by individual investors or in a simple holding company structure. However, it can become a substantial undertaking when a large non-U.S. financial institution desires to obtain NYSE membership for its U.S. broker-dealer.

Any affiliated entity (or controlling individual) that falls within the definition of an approved person is required to file an application to become an approved person. The application, on NYSE Form AP-1,  

\begin{itemize}
  \item \textsuperscript{113} NYSE Rules 304A[a], 304[b] and 311.17.
  \item \textsuperscript{114} See FINRA Regulatory Notice 08-64 (Oct. 2008) [substitution of “principal executive” for “allied member”], and Incorporated NYSE Rule 311.17 (definition of “principal executive”).
  \item \textsuperscript{115} This term is in turn defined in Rule 2[g] to mean “transacting business generally as a broker or dealer in securities, including[,] but not limited to, servicing customer accounts or introducing them to another person.” The NYSE interprets the term to extend to non-U.S. entities that are not subject to U.S. broker-dealer registration.
  \item \textsuperscript{116} NYSE Rule 2[d].
\end{itemize}
includes an undertaking to abide by applicable NYSE rules\textsuperscript{117} and, significantly, an agreement to permit examination by the NYSE of the approved person’s books and records, albeit only “to verify the accuracy of the information” provided to the NYSE. Exceptions to this examination authority are made to the extent required by bank secrecy or similar laws of non-U.S. jurisdictions.\textsuperscript{118} Nonetheless, the grant of authority to examine books and records can be a contentious issue for affiliates of a broker-dealer applying for membership.\textsuperscript{119}

On a more mundane note, Form AP-1 requires notarization of the applicant’s signature and, if the application is executed outside the United States, official evidence of the authority of the notary to act as such. This can present practical difficulties in some jurisdictions, such as Hong Kong, that do not appear to be equipped to provide current certifications of notarial authority. An application will not be approved until the NYSE is satisfied that this requirement has been fulfilled.

[D] Statutory Disqualifications

The NYSE prohibits any member, member organization, allied member, approved person, employee, or other person in a control relationship with a member or member organization from having associated with it any person who is known, or in the exercise of reasonable care should be known, to be subject to any “statutory disqualification” as defined in Exchange Act section 3[a][39]. Exceptions may be granted upon application to the NYSE.\textsuperscript{120} The NYSE Rule Harmonization Filing would limit the application of this prohibition to persons subject to the jurisdiction of the NYSE.

§ 2:5.3 Opinions of Counsel

Applicants for NYSE membership are also required to furnish two opinions of outside counsel with respect to the issuance of the applicant’s securities. Where outside counsel has not represented the applicant since the inception of its operations, the applicant’s records may be insufficiently detailed to support the required opinions and

\textsuperscript{117} For a discussion of NYSE Rule 346[f] under “Statutory Disqualifications,” see infra section 2:5.2[D].
\textsuperscript{118} NYSE Rule 304.10.
\textsuperscript{119} In February 2006, the NYSE proposed to narrow its definition of “approved person” to encompass primarily persons who control a member organization and to create a new category of “related persons” that would be required to enter into agreements with member organizations but not register with the NYSE. File No. SR-NYSE-2006-10 (Feb. 22, 2006). This proposal was subsequently withdrawn.
\textsuperscript{120} NYSE Rule 346[f].
remedial measures may be necessary. Rather than treating this exercise as a nuisance, applicants should be encouraged to view it as an opportunity to get their corporate housekeeping into good order, which clearly is a desirable goal in the current regulatory environment.

[A] Rule 313.20

Rule 313.20 requires an opinion of counsel to the effect that a firm applying for membership is duly organized and existing, that its stock is validly issued and outstanding and that “the restrictions and provisions required by the Exchange on the transfer, issuance, conversion and redemption of its stock have been made legally effective.”\(^\text{121}\)

Although Rule 313.20 applies by its terms only to corporations, the NYSE has in practice applied it to all forms of organization including partnerships and limited liability companies. Counsel engaged by an operating broker-dealer to assist in the NYSE membership application process may find that the broker-dealer has issued (and redeemed) securities on numerous occasions in the past, for example as individuals became active in the business (and retired). A firm’s records may not in all instances reflect the authorizations for such issuances that are required under state law or the firm’s own organizational documents. In such circumstances, counsel should consider the steps that will be sufficient to enable the rendering of the opinion. In some cases, for example, ratification of prior issuances may be sufficient; in other cases more comprehensive measures such as a recapitalization may be necessary.

[B] Former Rule 313(d)

Former Rule 313[d] related to the offer and sale of securities by a broker-dealer as a means of raising capital: counsel was required to furnish an opinion that the offer and sale was conducted in compliance with federal and state securities laws. If the securities were offered pursuant to a registration statement under the Securities Act, the opinion was required to include a standard “negative assurances” statement regarding the disclosure in the registration statement and an opinion as to compliance with form requirements. A Rule 313(d) opinion was required whenever a member firm or applicant for membership raises capital in the form of equity or a subordinated loan.

In practice, of course, few broker-dealers offer their own securities directly to the public, because public financing, if any, is generally obtained by a holding company. Direct financing of a broker-dealer

\(^{121}\) For a discussion of the “provisions required by the Exchange,” see infra section 2:5.4.
is usually limited to equity investments and subordinated loans from its individual or corporate owners, and these generally are, or can be, structured as private placements under the Securities Act. Thus, Rule 313(d) opinions were most often private placement opinions.

Former NYSE Rule 420 extended the Rule 313(d) opinion requirement to subordinated loans and secured demand notes used to finance a broker-dealer’s operations. Rules 313(d) and 420, both NYSE Incorporated Rules, were deleted from the NYSE rulebook as part of the FINRA rulebook consolidation process in November 2009.\textsuperscript{122} New FINRA Rule 4110.01 replaced the opinion requirement with a requirement that the member firm “assure itself” that any applicable provisions of the Securities Act of 1933 and State Blue Sky laws have been satisfied. A member may be required to submit to FINRA evidence of its assurance prior to approval of a subordinated loan agreement.\textsuperscript{123} Rule 4110.01 applies to all FINRA members, not just NYSE member firms.

\textbf{§ 2:5.4 Mandatory Charter Provisions}

An applicant for NYSE membership will be required to amend its corporate charter, partnership agreement or limited liability company operating agreement (any of which is referred to in this section as the “charter” for convenience) to incorporate certain mandatory provisions. These provisions restrict withdrawals of capital and incapacitate individuals who do not comply with NYSE approval requirements. The NYSE will provide suggested forms for each of these provisions. Beyond adding the mandatory provisions, an applicant’s entire charter is subject to review and approval by the NYSE.\textsuperscript{124}

\textbf{[A] Limitations on Withdrawals of Capital}

The required charter provision prohibits a member organization from permitting the withdrawal of a capital contribution or redeeming or repurchasing any shares of its stock on less than six months’ notice to the exchange, which notice may be given no sooner than six months after the capital contribution or original issuance of the shares.\textsuperscript{125} This effectively locks in capital for a minimum one-year period.

\begin{itemize}
  \item \textsuperscript{122} SEC Release No. 34-60933 [Nov. 4, 2009], relating to File No. SR-FINRA-2008-067.
  \item \textsuperscript{123} \textit{Id}.
  \item \textsuperscript{124} NYSE Rules 313(a) and (b).
  \item \textsuperscript{125} NYSE Rules 312(h) [redemptions and repurchases of stock] and 313.11 [withdrawals of capital contributions].
\end{itemize}
An additional provision, which applies to the charters of member organizations organized in any form other than a New York corporation, prohibits the declaration or payment of dividends and the making of any other distributions unless the value of the organization’s assets after giving effect to the distribution will be “at least equal to the aggregate of its debts and liabilities, including capital.”

[B] Disabling Provision

A member organization’s charter must provide that, if any person who is, or is required to be, approved by the NYSE as a member, allied member, or approved person in respect of that member organization ceases or fails to be so approved, then, to the extent that person owns an equity interest in the member organization, the equity interest must be redeemed or converted to a fixed income interest so that the person in question may no longer exercise a controlling interest over the member organization. The member organization must agree that the NYSE may suspend its privileges until the conversion or redemption occurs.

§ 2:5.5 Prohibitions on Dual Employment

Exchanges generally take a more restrictive approach to dual employment of registered personnel than FINRA’s. Under FINRA rules, registered personnel of one member firm must give notice of any outside business activities and may not engage in securities activities outside the scope of their employment if the member firm disapproves of their participation. Under NYSE rules, personnel with supervisory responsibility at a member firm must dedicate 100% of their time to the member firm unless the firm’s written consent is obtained; AMEX rules require that permission be obtained from the AMEX. An NYSE member firm may approve such an arrangement

126. The substance of this particular provision is included in the New York Business Corporation Law. N.Y. BUS. CORP. LAW § 510(b) [distributions payable out of surplus only]. Section 510(b) was amended in 2008 to permit distributions out of the current or prior year’s net profits in cases where there is no surplus, subject to certain limitations. The NYSE Rules Harmonization Filing would eliminate the exception for New York corporations.

127. NYSE Rule 313.23.

128. NYSE Rule 313.22.

129. NYSE Rule 311.13.

130. NASD Conduct Rules 3030 and 3040.

131. NYSE Rule 346(e). Until 2008, the written approval of the NYSE was required. In September 2005, the NYSE approved amendments to its interpretations under Rule 311 that provide guidance on the qualification and approval requirements for “principal executive officers” (as defined in
only if it makes a good-faith determination that the arrangement will in no way compromise the protection of investors or the public interest; compromise the supervisor’s duties at the member organization; or give rise to a material conflict of interest.

An additional constraint upon individuals who are exchange members is that they may not qualify more than one member organization for membership. No exceptions are made to this restriction. The NYSE Rule Harmonization Filing would eliminate this restriction.

§ 2:6 State Registration Requirements

The National Securities Markets Improvement Act of 1996 (NSMIA) introduced federal pre-emption of state regulation of certain securities activities, but that pre-emption did not extend to state registration of broker-dealers that are registered with the SEC. Each state, district, and territory continues to have its own requirements for the registration of broker-dealers who conduct a securities business there and, absent an exemption from registration, a broker-dealer will have to register in each state in which it intends to conduct business.

A broker-dealer that effects a transaction in a state in contravention of its registration requirements may be subject to administrative actions by the state. In addition, customers in the state may have the right to rescind all transactions with the unregistered firm. In the case of rescissions, state law generally mandates interest on the amount of consideration paid, from the date of the investment, at rates as high as 15% per annum.

Rule 311(b)(5)) who serve in two or more capacities. See NYSE Information Memorandum 05-69 [Sept. 16, 2005]. For a discussion of the change in the defined term to “principal executives” and the modification of the definition, see supra section 2:5.2[B].

132. For a discussion of the distinction between members and member organizations, see supra section 2:5.1.

133. NYSE Rule 346(d).

134. NSMIA amended § 18 of the Securities Act of 1933 to preempt state registration of certain securities offerings, and added § 203A of the Investment Advisers Act of 1940, which preempts state registration of certain investment advisers.

135. The analysis of the need for state registration as a broker-dealer is independent of the analysis of whether a broker-dealer organized in one state will need to qualify to do business as a foreign entity in other states. Whereas the latter analysis commonly turns on the maintenance of a place of business in a state, the former analysis, as discussed in the text, turns on the nature of the business conducted in a state, and the maintenance of a place of business is not necessarily determinative.
Fortunately, NSMIA did amend the Exchange Act to provide that no state may establish "capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements" for broker-dealers that differ from, or are in addition to, the requirements established under the Exchange Act.\(^{136}\) As a result, the registration process in most states involves only the submission of Form BD through the CRD system and the payment of a fee. Once a broker-dealer is registered in a state, amendments to Form BD that are filed electronically with the CRD are delivered to the state automatically, so separate filings are not ordinarily required.

Many states provide exemptions from broker-dealer registration for offers and sales made solely to dealers or to certain specified institutional investors.\(^{137}\) In some states the institutional exemption is available only if the broker-dealer does not maintain a place of business in the state. Some states do not require registration by persons not having a place of business in the state if the number of persons other than institutional investors with whom securities transactions are effected in the state is less than a specified number. If sales or purchases, or offers to sell or purchase, will be made in a state without an available exemption, registration will generally be required.

For example, New York provides an exemption from broker-dealer registration for private placements to certain institutions, but it does not provide an exemption for sales of publicly traded securities either to dealers or to institutions.\(^{138}\) Registration in New York will generally be necessary if any transactions in publicly traded securities are expected to be effected there. In contrast, Florida does not require broker-dealer registration [even if a broker-dealer maintains a place of business in Florida] provided that offers and sales are made only to the following types of institutions: dealers, banks, savings institutions,

\(^{136}\) Exchange Act § 15(h)[1]. In addition, § 15(h)[2] provides a limited exemption from state registration for certain de minimis transactions by associated persons of a broker-dealer. The authority of states to regulate sales practices was not affected by NSMIA. See, e.g., In the Matter of Jack Kleck, Oregon Dep’t of Consumer & Bus. Svcs., No. S-07-0001 [Jan. 17, 2008] [department revoked the securities license of a stockbroker and fined him $100,000 after finding he advised more than a dozen senior citizen clients to become “general partners” in risky oil and gas ventures; in one instance, he accompanied an eighty-nine-year-old man suffering from dementia to a bank branch and instructed the visibly confused client to withdraw funds for investment purposes].

\(^{137}\) In some states this is handled as an exclusion from the definition of broker-dealer, and in other states as an exclusion from the requirement to register as a broker-dealer.

\(^{138}\) N.Y. GEN. BUS. LAW § 359-c[1][a]. In New York, unlike most states, an issuer may be required to register as a dealer in its own securities. Id.
trust companies, insurance companies, investment companies, pension or profit-sharing trusts, and other persons who come within the definition of “qualified institutional buyer” contained in Rule 144A under the Securities Act.\footnote{Florida Securities & Investor Protection Act § 517.12[3] and § 517.061[7].}

The consequence of this patchwork regulatory regime is that a broker-dealer must either register in each state in which it anticipates engaging in securities transactions or it must evaluate the exceptions available in each state case by case. There are no reliable rules of thumb, although a retail securities business will almost invariably require state registration. Some broker-dealers maintain registrations in all fifty states in order to avoid the need to analyze the availability of an exemption for each customer in a new state. Centralized filing through the CRD system has made it easier to maintain registrations in every state, but the incremental costs of filing and remaining subject to oversight in each additional state should be considered before a new business follows this path.

The broker-dealer registration requirements of many states provide that representatives who conduct a securities business in-state must pass the Uniform Securities Agent State Law Examination (Series 63). The Series 63 is in addition to examination requirements imposed by FINRA, such as Series 7.