



Financial Industry Regulatory Authority

**Patricia Albrecht**  
Associate General Counsel

Direct: (202) 728-8026  
Fax: (202) 728-8264

May 8, 2012

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: File No. SR-FINRA-2012-018 – Response to Comments**

Dear Ms. Murphy:

This letter responds to comments submitted to the Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced rule filing,<sup>1</sup> a proposed rule change to amend NASD Rules 1012 (General Provisions) and 1017 (Application for Approval of Change in Ownership, Control, or Business Operations) to adopt Form CMA, a new standardized electronic form to be used by all continuing membership applicants as part of their continuing membership applications (“applications”). New Form CMA will seek to elicit information from applicants in a manner consistent with the standards of admission contained in NASD Rule 1014 (Department Decision), against which NASD Rule 1017 requires each application to be evaluated.<sup>2</sup>

As discussed in the Proposing Release, new Form CMA’s structure and guidance is designed to obtain the basic information needed for all applicants with embedded flexibility to provide for variations based on the particular application type being submitted. Additionally, new Form CMA will provide certain user-friendly features, such as pre-populating certain fields with information provided to FINRA in other submissions (*e.g.*, Central Registration Depository (CRD®) entitlement forms

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<sup>1</sup> See Securities Exchange Act Release No. 66508 (March 2, 2012), 77 FR 14052 (March 8, 2012) (Notice of Filing of File No. SR-FINRA-2012-018) (the “Proposing Release”).

<sup>2</sup> While NASD Rule 1014 sets forth 14 standards for membership, Form CMA does not elicit specific information from the applicant regarding standards 13 (FINRA does not possess information indicating that the applicant may circumvent the federal securities laws or FINRA rules) or 14 (the application is consistent with the federal securities laws and FINRA rules). See NASD Rule 1014(a)(13) and (14).

and Form BD) or otherwise available to FINRA from CRD records (*e.g.*, continuing education status) and including a number of optional information request fields that can be used by applicants to provide additional information if and when it is applicable to the applicant's proposed change.

The Commission received four comment letters in response to the proposal.<sup>3</sup> The comments received by the Commission on the proposed rule change and FINRA's responses to the comments are discussed in detail below.

#### A. Support for Proposal

Two commenters expressed overall support for the proposed rule change and new Form CMA,<sup>4</sup> as well as expressing support with specific aspects of Form CMA, such as the form's approach of soliciting basic information while also permitting applicants to include information that is particular to the applicant and the contemplated change<sup>5</sup> and Form CMA's pre-population of certain information fields with information provided to FINRA in other submissions, such as CRD entitlement forms and Form BD, or otherwise available to FINRA from CRD records.<sup>6</sup> One commenter also suggested that the internet-based standardized Form CMA would reduce compliance burdens and costs, specifically noting that the proposed form would reduce the time to prepare the necessary information to be submitted.<sup>7</sup>

#### B. Impact on Applicants

Two commenters, however, questioned the impact Form CMA would have on applicants. Specifically, one commenter suggested that the amount of detail requested

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<sup>3</sup> Letter from Kevin A. Carreno, President, Experts Counsel Inc., to Elizabeth M. Murphy, Secretary, SEC, dated March 14, 2012 ("Experts Counsel"); letter from David T. Bellaire, Esq., General Counsel and Director of Government Affairs, Financial Services Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 29, 2012 ("FSI"); letter from Howard Spindel, Senior Managing Director, Integrated Management Solutions USA LLC, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 29, 2012 ("IMS"); and letter from Stephen H. Cohen, Partner, Loeb & Loeb LLP, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 29, 2012 ("Cohen").

<sup>4</sup> IMS, FSI.

<sup>5</sup> FSI.

<sup>6</sup> IMS. As further detailed herein, IMS also raised concerns with various aspects of Form CMA.

<sup>7</sup> FSI.

in the “one size fits all” Form CMA would cause delays and confusion for most continuing membership applicants, with the form significantly increasing the administrative burden on small firm applicants.<sup>8</sup> The commenter requested that the SEC require FINRA to conduct a more comprehensive review of the CMA process to provide greater flexibility for small firms. Another commenter also suggested that Form CMA’s information requirements would create unnecessary and burdensome information and filing requirements on applicants, as well as increase unnecessarily the time required to review an application by requiring FINRA staff to review irrelevant information.<sup>9</sup>

FINRA disagrees with the “one size fits all” description of new Form CMA and the commenters’ suggestions that new Form CMA will result in unnecessary burdens, delays, and/or confusion for continuing membership applicants and FINRA staff. As stated in the Proposing Release, Form CMA has been designed to provide continuing membership applicants with the same benefit of a streamlined application process that new member applicants currently experience with Form NMA, including, but not limited to, significantly reducing administrative delays that exist in today’s manual continuing membership application process. To that end, as stated above, Form CMA’s structure and guidance is designed to obtain the basic information needed for all applicants with embedded flexibility to allow for variations based on the particular application type being submitted. Also as noted above, Form CMA includes user-friendly features, such as pre-populating fields with information previously provided to FINRA and providing optional information fields that applicants may use to provide additional applicable information. These features were specifically included to minimize the time necessary for applicants to complete the new form and reduce the administrative burden placed on continuing membership applicants. The optional field approach also is intended to provide flexibility for the significant level of variation seen in members’ structures, business lines, and proposed changes, as well as permit applicants to provide additional information relevant to the facts and circumstances of their particular applications. For these reasons, FINRA believes that new Form CMA will reduce significantly an applicant’s time to complete the form and administrative burden of providing additional information during the continuing membership application review process, as well as reduce the time necessary for FINRA staff to review continuing membership applications, in part, by lessening the need to request additional information from applicants.

FINRA also disagrees with the assertion that Form CMA will significantly increase small firm applicants’ administrative burden and believes it has incorporated sufficient flexibility into Form CMA for small firm applicants, as well as other types of applicants. As FINRA noted in the Proposing Release, FINRA worked closely with an industry task force comprised of representatives from member firms during the

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<sup>8</sup> Experts Counsel.

<sup>9</sup> Cohen.

development of new Form CMA.<sup>10</sup> Because the majority of task force members were representatives from small firms, several of whom also act as consultants for continuing membership and new membership applicants,<sup>11</sup> FINRA gained valuable insight regarding the potential impact of Form CMA on small firm applicants. Additionally, the task force's input assisted FINRA to make changes intended to provide flexibility and reduce all applicants' administrative burdens when completing Form CMA. Those changes include structuring the form to elicit information from applicants in a manner consistent with the NASD Rule 1014 standards of admission and providing the optional and pre-populated information fields.

### C. Suggested Amendment to NASD Rule 1017

As originally proposed, NASD Rule 1017(b)(2) would require a continuing membership application to include a "Form CMA and a detailed description of the change in ownership, control, or business operations, including a business plan, pro forma financials, an organizational chart, and written supervisory procedures reflecting the change." One commenter suggested that, to avoid potential confusion, FINRA should amend NASD Rule 1017(b)(2) to delete the references to a business plan, pro forma financials, organizational chart, and written supervisory procedures, as they would be included as part of a filed Form CMA.<sup>12</sup> In response, FINRA is proposing to delete those specified items and revise the proposed language to require that an applicant submit an application that includes a "Form CMA including a detailed description of the change in ownership, control, or business operations."

### D. Form CMA Format Issues

One commenter suggested that Form CMA should always precede its data requests by a preliminary screening question eliciting a "yes" or "no" response to determine whether such data would be applicable to the proposed change. As an example, the commenter noted that a question in Standard 1 (Overview of the Applicants) of the form requesting information for any persons or entities that would become associated or affiliated with the applicant as a result of the proposed change would be inapplicable to a simple addition of a business line that would not result in

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<sup>10</sup> The task force also assisted FINRA in restructuring the content of existing Form NMA, the standardized online application used by applicants for FINRA membership. *See* Securities Exchange Act Release No. 66555 (March 9, 2012), 77 FR 15445 (March 15, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2012-017).

<sup>11</sup> Specifically, the task force comprised representatives from seven member firms, with five task force members representing small member firms.

<sup>12</sup> Cohen.

additional personnel or a change in net capital.<sup>13</sup> In response, FINRA reminds commenters that Form CMA is dynamic and will exclude or include certain questions based on the type of continuing membership application indicated by the applicant at the beginning of the form. Thus, the commenter's example question would only be presented if an applicant indicated at the beginning of the form that it is filing an "ownership or asset transfer change[]" continuing membership application.<sup>14</sup>

The same commenter suggested that applicants should be able to override Form CMA's pre-populated data if there are errors, especially when the source systems, such as CRD, are unavailable for extended periods of time. As an initial matter, FINRA notes that CRD is the only source system currently linked to Form CMA, and applicants are responsible for ensuring the accuracy of the CRD information applicable to them. To correct information errors in Form CMA's pre-populated fields, an applicant must correct the corresponding information in CRD. Form CMA is designed to reflect any updates or changes to information made by an applicant on CRD the next day after the change. FINRA makes CRD generally available Monday through Friday from 7 a.m. to 11 p.m. Eastern Time ("ET") and three Saturdays per month from 8 a.m. until 6 p.m. ET, and provides a detailed availability schedule on its website identifying dates and times when CRD is unavailable and the reasons for such unavailability (*e.g.*, software updates, system maintenance, holidays).<sup>15</sup> FINRA believes that such access and notice of unavailability provides applicants with the ability to correct any information errors in Form CMA's pre-populated fields in a timely manner. Additionally, requiring applicants to update CRD rather than provide a mechanism to override Form CMA's pre-populated fields helps ensure the overall consistency and accuracy of the applicant's information.

#### E. Form CMA Content Issues

Commenters raised several questions regarding the information requested in certain sections of Form CMA.

##### 1. Comments on Standard 1 (Overview of the Applicants)

Standard 1 of Form CMA seeks applicant overview information relevant to the identified proposed change in membership (*e.g.*, details of the proposed business change, verification of current business activities, new business lines added,

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<sup>13</sup> IMS.

<sup>14</sup> Form CMA's first question requires an applicant to identify the type of continuing membership application being filed, with the available choices identified as either "ownership or asset transfer changes" or "change(s) in business operations." *See* Form CMA, Application Type Section.

<sup>15</sup> *See* [Web CRD Availability Schedule](#).

supervisors for new business lines, identification of other persons associated with the proposed business change, as applicable). One commenter objected to the section's information requests for affiliate information, formation documents for new direct or indirect owner entities including holding companies, verification of current business activities, and "a statement describing how the Applicant and its Associated Persons (registered and unregistered) will be compensated for the proposed activities" on the basis that such information requests were broader and more detailed than the scope of information currently sought by FINRA during a continuing membership application review. The commenter also described the request for compensation information for an applicant and its associated persons for proposed activities as broad and confusing regarding the detail required, noting that an applicant could have numerous compensation structures for its registered representatives based on complicated formulas.<sup>16</sup>

FINRA disagrees that the information requested in Standard 1 is broader and outside of the scope of information currently requested during the continuing membership application, as FINRA has previously routinely requested all of the above-mentioned information when it has been relevant to a particular continuing membership application. Form CMA reflects this practice and is designed to present an applicant the information requests that would be relevant to the type of continuing membership application the applicant indicates it is filing at the beginning of the form. For instance, information request fields to verify current business activities and outline compensation for proposed activities is only presented to applicants who have indicated at the beginning of Form CMA that the application is for a material change in business operations (*e.g.*, expansion of associated persons, offices, or number of markets made, removal or modification of a membership agreement restriction, adding a business line that requires a higher net capital). Similarly, information requests for affiliate information or formation documents for new direct or indirect owner entities would appear if an applicant indicates at the beginning of Form CMA that the application is for an ownership or asset transfer change.

With respect to the commenter's concerns regarding the level of required detail necessary for Form CMA's request for compensation information for an applicant's proposed activities, FINRA does not believe that Form CMA's information request for "a statement describing how the Applicant and its Associated Persons (registered and unregistered) will be compensated for the proposed activities" suggests that applicants need to provide on Form CMA granular detail regarding potential compensation structures. However, to avoid potential confusion on this issue, FINRA notes that it

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<sup>16</sup> Cohen. The commenter also suggests that this information request goes beyond the general current expectation that applicants need only provide a projection of income and expenses for a 12-month period. FINRA notes that the 12-month projection of income and expenses is a separate component of Standard 7 (Maintaining Adequate Net Capital) that an applicant is requested to provide if applicable to the proposed change in membership.

would expect an applicant to provide on Form CMA only a general statement describing the compensation arrangements for proposed activities.

2. Comments on Standard 3 (Compliance with Securities Laws, Just and Equitable Principles of Trade)

Standard 3 of Form CMA consists of specific requests for information (*e.g.*, disciplinary history) and documentation (*e.g.*, state or federal orders or decrees, statements of claims, cancelled checks for payment of arbitration awards, proofs of settlement, settlement agreements). The information collected pursuant to this standard will assist FINRA in evaluating whether an applicant is capable of meeting the standard in NASD Rule 1014(a)(3), which requires FINRA to determine whether an applicant is capable of complying with the federal securities laws, the rules and regulations thereunder, and FINRA rules.

One commenter suggested that the information field in Standard 3 requesting an applicant to indicate whether the applicant or any associated persons have violated the same federal securities laws or regulations or FINRA rules on more than one occasion is a new request that goes beyond the current information a continuing membership applicant must provide.<sup>17</sup> This assertion, however, is without merit, as FINRA currently requests and reviews such information when applicable during the continuing membership application process as part of its evaluation of the standard in NASD Rule 1014(a)(3). Repeated violations of the same federal securities law or regulations or FINRA rules would be valuable information in FINRA's consideration of whether an applicant is capable of complying with the federal securities laws, the rules and regulations thereunder, and FINRA rules.<sup>18</sup>

3. Comments on Standard 5 (Facilities)

Standard 5 of Form CMA consists of information requests regarding a continuing membership applicant's facilities (*e.g.*, material changes to facilities or locations, departmental information barriers, space sharing arrangements, lease and/or sub-lease agreements). The information collected pursuant to Standard 5 will assist FINRA's evaluation of the standard in NASD Rule 1014(a)(5), which requires FINRA to determine whether an applicant has adequate plans to obtain facilities that are

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<sup>17</sup> Cohen.

<sup>18</sup> Additionally, FINRA has previously found such information to be relevant when determining an applicant's compliance with NASD Rule 1014(a)(10)(J), which requires FINRA to consider when assessing an applicant's supervisory system and written procedures whether there is any other condition that would have a material impact on the applicant's ability to detect and prevent violations of the federal securities laws, the rules and regulations thereunder, and FINRA rules.

sufficient to (1) initiate the operations described in the Applicant's business plan, considering the nature and scope of operations and the number of personnel; and (2) comply with the federal securities laws, the rules and regulations thereunder, and FINRA rules.

One commenter requested that FINRA remove Standard 5's information request that an applicant indicate whether any proposed office would be located in a principal's residence, and if the residence is a leased property, whether the applicant has obtained the appropriate landlord or other consent to utilize the residential location for business purposes.<sup>19</sup> FINRA, however, has previously requested such information from applicants and found it to be relevant in determining whether an applicant has met the standard in NASD Rule 1014(a)(5), which would include determining whether there are any restrictions prohibiting an applicant from legitimately conducting its operations at a residence the applicant proposes to use as an office.

#### 4. Comments on Standard 6 (Communications and Operational Systems)

Standard 6 of Form CMA includes information requests regarding a continuing membership applicant's communications and operational systems (*e.g.*, communications and operational systems changes, supervision arrangements of

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<sup>19</sup> IMS. The commenter also objected to this information request on the basis that NASD Rule 3010(g)(2)(A)(ii) exempts many such arrangements by not recognizing private residences as branch offices. This provision, however, does not provide a blanket exemption for private residences from being considered a branch office. Rather, NASD Rule 3010(g)(2)(A)(ii) excludes from the definition of branch office any location that is an associated person's primary residence, provided that: (a) only one associated person, or multiple associated persons who reside at the location and are members of the same immediate family, conduct business at the location; (b) the location is not held out to the public as an office and the associated person does not meet with customers at the location; (c) neither customer funds nor securities are handled at the location; (d) the associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, advertisements, and other communications to the public by the associated person; (e) the associated person's correspondence and communications with the public are subject to the member's supervision in accordance with NASD Rule 3010; (f) electronic communications (*e.g.*, email) are made through the member's electronic system; (g) all orders are entered through the designated branch office or an electronic system established by the member that is reviewable at the branch office; (h) written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and (i) a list of the residence locations is maintained by the member.

multiple locations, business continuity plan documents, information relating to the applicant's use of social media sites). The information collected pursuant to Standard 6 will assist FINRA's evaluation of the standard in NASD Rule 1014(a)(6), which requires FINRA to assess whether an applicant's communications and operational systems employed for the purpose of conducting business with customers and other members are adequate and provide reasonably for business continuity.

One commenter objected to Standard 6's request that an applicant discuss its use of social media sites and how it would ensure compliance with FINRA's guidance regarding such mediums coupled with a request for screenshots of both applicant-facing and outward-facing pages of the social media sites on the basis that such information is not currently required.<sup>20</sup> This assertion, however, is without merit. FINRA considers social media sites to be a type of communication system and regularly requests such information and screenshots when an applicant is using, or intends to use, social media sites. Additionally, FINRA has found that applicants consider providing screen shots to be a convenient means of responding to FINRA's requests for information regarding an applicant's use of social media sites.

#### 5. Comments on Standard 10 (Supervisory Structure)

Standard 10 of Form CMA seeks information regarding a continuing membership applicant's supervisory structure (*e.g.*, changes to supervisory or management personnel, information regarding supervisors' experience and duties, chief compliance officer experience, non-FINOP outside business activities notifications). FINRA will rely upon such information in assessing whether an applicant can comply with NASD Rule 1014(a)(10), which requires an applicant to have a supervisory system, including written supervisory procedures, internal operating procedures (including operational and internal controls), and compliance procedures designed to prevent and detect, to the extent practicable, violations of the federal securities laws, the rules and regulations thereunder, and FINRA Rules.

A commenter objected to Standard 10's request for supporting documentation of all FINRA Rule 3270 notifications for principals, other than the applicant's FINOP, who have outside business activities on the basis that the request was overly broad and unnecessary, especially as FINRA Rule 3270 does not require such notifications to be filed with FINRA. The commenter also noted that the information would be available on a registered person's Form U4.<sup>21</sup> FINRA Rule 3270 requires a registered person to provide prior written notice to the member before engaging in outside business activities, and FINRA has routinely requested such notices from applicants in connection with a continuing membership application, as such information may bear upon the member's application. For instance, FINRA has found this information

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<sup>20</sup> Cohen.

<sup>21</sup> Cohen.

particularly relevant when a registered principal's existing outside business activity relates to a new line of business that an applicant proposes to engage in, in which case an applicant may need to consider whether continued participation by principals in certain outside business activities would be appropriate in light of the proposed business line. One of the elements of Rule 3270 that a member shall consider with respect to any outside business activity is the extent to which such business activity will be "viewed by customers or the public as part of the member's business," which in turn, is based, in part, on the scope of the member's business. Accordingly, FINRA considers such information to be relevant to determining whether an applicant can comply with the standard in NASD Rule 1014(a)(10). Furthermore, the referenced information request is an optional field for applicants to use, as applicable, given the particular facts and circumstances of their applications.

#### F. Outside the Scope of the Proposal

Two commenters suggested that FINRA reduce the 180-day time frame NASD Rule 1017 provides for FINRA to approve a continuing membership application,<sup>22</sup> with one of the commenters suggesting that FINRA provide a "fast track" approval process, either limited to uncomplicated continuing membership applications, or that applicants could access for a fee.<sup>23</sup> The other commenter contended that NASD Rule 1017 places significant limits on small firms seeking to raise capital in a timely fashion.<sup>24</sup> FINRA considers these comments to be outside the scope of the proposal, which is limited to proposed rule changes to NASD Rules 1012 and 1017 to adopt new Form CMA. FINRA, however, continues to evaluate opportunities to streamline the application process or, where appropriate, consider revisions or amendments to FINRA's membership rules.<sup>25</sup>

Additionally, one of the commenters questioned why FINRA did not solicit comments from members in a *Regulatory Notice* prior to filing the proposal with the SEC.<sup>26</sup> FINRA also considers this comment to be outside the scope of the proposal. However, FINRA notes that the self-regulatory organization rulemaking process does not require that a proposed rule change be published for comment in a *Regulatory Notice* prior to its filing with the SEC. Rather, depending on the facts and circumstances surrounding the rule proposal, the FINRA Board may authorize the

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<sup>22</sup> IMS, Experts Counsel.

<sup>23</sup> IMS.

<sup>24</sup> Experts Counsel.

<sup>25</sup> See *Regulatory Notice 10-01* (January 2010) proposing the transfer of the NASD Rule 1010 Series (Membership Proceedings), including NASD Rules 1012 and 1017, with substantive changes, into the Consolidated FINRA Rulebook.

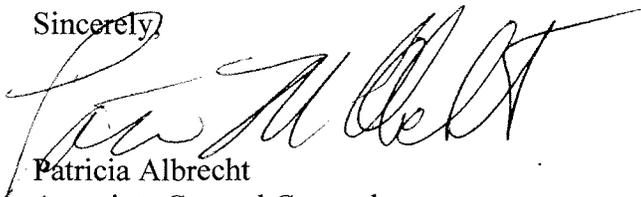
<sup>26</sup> IMS.

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publication of a *Regulatory Notice* soliciting comment on the proposal or the filing of the proposal with the SEC for notice and comment.<sup>27</sup> Regarding this proposed rule change, FINRA notes the significant industry insight provided by the industry task force mentioned above that assisted FINRA's development of Form CMA. FINRA also consulted with its advisory committees in connection with the development of the form.

FINRA believes that that foregoing, along with the discussion in the original rule filing, fully responds to the issues raised by the commenters. If you have any questions, please contact me at 202-728-8026.

Sincerely,

A handwritten signature in black ink, appearing to read 'Patricia Albrecht', written over a horizontal line.

Patricia Albrecht  
Associate General Counsel