

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63316; File No. SR-FINRA-2010-056)

November 15, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 1113 (Restriction Pertaining to New Member Applications) and to Amend the FINRA Rule 9520 Series (Eligibility Proceedings)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 1, 2010, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt new FINRA Rule 1113 (Restriction Pertaining to New Member Applications) and to amend the FINRA Rule 9520 Series (Eligibility Proceedings) to restrict new member applicants’ and certain members’ association with disqualified persons.

The text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA is proposing a rule change to adopt new FINRA Rule 1113 (Restriction Pertaining to New Member Applications) and to amend the FINRA Rule 9520 Series (Eligibility Proceedings) to restrict new member applicants' and certain members' association with disqualified persons. The details of the proposed rule change are described below.

Background

Article III, Section 3(b) of the FINRA By-Laws provides that no person shall be associated with a member, continue to be associated with a member, or transfer association to another member if such person is or becomes subject to disqualification; and that no firm shall be admitted to membership, and no member shall be continued in membership, if any person associated with it is subject to a disqualification. Pursuant to Article III, Section 4 of the FINRA By-Laws, a person is subject to a "disqualification" with respect to membership, or association

with a member, if such person is subject to any “statutory disqualification” as such term is defined in Exchange Act Section 3(a)(39).³

The FINRA Rule 9520 Series sets forth procedures for a person to become or remain associated with a member, notwithstanding the existence of a statutory disqualification, and for a current member or person associated with a member to obtain relief from the eligibility or qualification requirements of the FINRA By-Laws and rules. The FINRA Rule 9520 Series also contemplates that a new member applicant may sponsor a proposed associated person or itself for relief from the eligibility or qualification requirements. A member (or new member applicant) seeking to associate with a person subject to a disqualification must seek approval from FINRA by filing a Form MC-400 application, pursuant to the FINRA Rule 9520 Series. Members (and new member applicants) that are themselves subject to a disqualification that wish to obtain relief from the eligibility requirements are required to submit a Form MC-400A application.

New Membership Application Rule

FINRA is proposing to adopt new FINRA Rule 1113 providing that the Department of Member Regulation (“Department”) shall reject an application for FINRA membership⁴ in which

³ See 15 U.S.C. 78c(a)(39). Pursuant to Exchange Act Section 3(a)(39), a person is subject to a “statutory disqualification” with respect to membership or participation in, or association with a member of, a self-regulatory organization (“SRO”) if such person, among other things: has been convicted of certain misdemeanor and all felony criminal convictions for a period of ten years from the date of the filing of an application for membership or participation in, or to become associated with a member of, such SRO; is subject to a temporary or permanent injunction (regardless of its age) issued by a court of competent jurisdiction involving a broad range of unlawful investment activities; has been expelled or suspended from membership or participation in an SRO; or is subject to an SEC order denying, suspending, or revoking broker-dealer registration.

⁴ Proposed FINRA Rule 1113, by its terms, will not apply to a member submitting a continuing membership application pursuant to NASD Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations).

either the applicant or an associated person, as defined in Article I of the FINRA By-Laws,⁵ of the applicant is subject to a statutory disqualification, as defined in Article III, Section 4 of the FINRA By-Laws.⁶ The proposed rule also provides that any new member application that the Department approves by virtue of Department or applicant error (including, but not limited to, an inadvertent or intentional misstatement or omission by the applicant or associated person) shall be subject to membership cancellation in accordance with FINRA Rule 9555 (Failure to Meet the Eligibility or Qualification Standards or Prerequisites for Access to Services).

FINRA believes that a new member applicant should enter the membership application process free of the concerns and issues that can arise from either being associated with a disqualified person or being itself subject to a statutory disqualification. Also, a new member applicant has no prior operating or supervisory history, and therefore, would not be able to demonstrate adequately its ability to supervise a disqualified person.

FINRA Rule 9520 Series Amendments

FINRA also is proposing several amendments to the FINRA Rule 9520 Series, which, as noted above, set forth the eligibility proceedings. First, the proposed rule change would amend

⁵ Article I of the FINRA By-Laws defines an associated person as a: (1) a natural person who is registered or has applied for registration under FINRA rules; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under its By-Laws or rules; and (3) for purposes of FINRA Rule 8210, any other person listed in Schedule A of Form BD of a member. See FINRA By-Laws, Article I (rr) (definition of “person associated with a member” or “associated person of a member”).

⁶ As previously noted, Article III, Section 4 of the FINRA By-Laws incorporates the definition of “statutory disqualification” as such term is defined in Exchange Act Section 3(a)(39).

the FINRA Rule 9520 Series definition of “sponsoring member”⁷ to eliminate the reference to new member applicants. As stated above, FINRA is concerned about the ability of new member applicants to supervise adequately a disqualified person, as such new member applicants generally would not have any prior operating or supervisory history that would indicate the necessary experience to supervise disqualified persons. Thus, this amendment conforms to the proposed new membership application rule discussed above by precluding new member applicants from being able to sponsor disqualified persons.⁸

Second, the proposed rule change would amend the definition of “disqualified member”⁹ in the FINRA Rule 9520 Series to clarify that a new member applicant is not eligible to submit an application for relief under the FINRA Rule 9520 Series where the new member applicant itself is subject to a disqualification.

Lastly, the proposed rule change would further amend the definition of “sponsoring member” to preclude any member from sponsoring the association or continued association of a disqualified person to be admitted, readmitted, or permitted to continue in association that is directly or indirectly a beneficial owner of more than five percent of the sponsoring member. This proposed change reflects FINRA’s belief that a member cannot effectively supervise such a disqualified person in light of the inherent conflict of interest resulting from the ownership interest. In FINRA’s experience, a member’s decision to sponsor such a person is nearly always influenced more by that person’s beneficial ownership interest in the firm, rather than by

⁷ FINRA Rule 9521(b)(4).

⁸ The proposed rule change also would make conforming amendments throughout the FINRA Rule 9520 Series to reflect the proposed amendment discussed above that a new member applicant may not sponsor a person subject to a disqualification.

⁹ FINRA Rule 9521(b)(2).

objective considerations, such as the person's work experience, the length of time since the disqualifying event, the person's professional activities since the time of the disqualifying event, or subsequent lack of disciplinary history.¹⁰

FINRA notes that the proposed rule change is not designed to apply in several situations. Proposed new FINRA Rule 1113 would not apply to a new member applicant that itself is subject to a statutory disqualification solely due to its association with a non-natural person that is subject to a statutory disqualification.¹¹ Also, in such situations, notwithstanding the proposed rule change to the FINRA Rule 9520 Series that would preclude a new member applicant from submitting an application for relief under the FINRA Rule 9520 Series, the new member applicant would be permitted to file an MC-400A application on behalf of itself.

Moreover, the proposed amendments to the FINRA Rule 9520 Series that would preclude any member from sponsoring a disqualified person that is directly or indirectly a beneficial owner of more than five percent of the sponsoring member would not preclude a member from filing an MC-400A application to sponsor itself where needed (e.g., a member whose majority owner is subject to a 30-day principal suspension for failure to supervise a books and records

¹⁰ See *The Ass'n of X as a Gen. Secs. Representative, Chairman, CEO, and owner, Redacted Decision No. SD99013 (NASD NAC 1999)* at 9 (the National Adjudicatory Council denied a sponsoring firm's statutory disqualification application, finding that the proposed supervisor would not adequately supervise a disqualified individual who would be 100 percent owner of the firm).

¹¹ Exchange Act Section 3(a)(39)(E) subjects a person to a statutory disqualification if the person is associated with any person who is known, or in the exercise of reasonable care should be known, by him to be subject to any statutory disqualification described in Exchange Act Sections 3(a)(39)(A) through (D). Because the applicable definition of "associated person" (set forth in Exchange Act Section 3(a)(21)) includes non-natural persons, a member may find itself subject to a statutory disqualification solely because it is associated with a person who is subject to a statutory disqualification pursuant to Exchange Act Section 3(a)(39)(A) through (D). For additional information, see Regulatory Notice 09-19 (April 2009).

violation may seek to sponsor itself for continued membership rather than having to cease business for the period of its owner's suspension).

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 90 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹² which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change will further these purposes by restricting certain members and new member applicants from being able to associate with statutorily disqualified persons in light of the concerns to investor protection raised by such associations.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds

¹² 15 U.S.C. 78q-3(b)(6).

such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2010-056 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2010-056. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2010-056 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹³

Florence E. Harmon
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).