FINANCIAL SERVICES INSTITUTE
VOICE OF INDEPENDENT BROKER-DEALERS AND INDEPENDENT FINANCIAL ADVISORS
www.financialservices.org

VIA ELECTRONIC MAIL

March 5, 2010

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Regulatory Notice 10-01 – FINRA's Membership Application Proceedings

Dear Ms. Asquith:

On January 4, 2010, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 10-01 (RN 10-01) requesting comment on a proposal to revise certain provisions of the existing membership rules (Proposed Rules).[1] The Proposed Rules are intended to streamline the standards of review for new and continuing membership applications (CMA), clarify certain administrative aspects of the Membership Application Process (MAP), update or eliminate outdated terminology, require certain additional information about the applicant, and incorporate certain provisions from the Incorporated NYSE membership rules.[2]

The Financial Services Institute (FSI)[3] welcomes this opportunity to comment on the Proposed Rule. We appreciate FINRA's efforts to streamline and clarify the membership rules. However, we have significant concerns with the Proposed Rules. In general terms, these concerns are based upon our belief that the Proposed Rules provide FINRA with excessively broad authority to request documents and information from firms, impose vague standards of review, and seek to extend FINRA's jurisdiction well beyond its traditional bounds.

Background on FSI Members

The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

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[1] See FINRA Regulatory Notice 10-01, available at http://www.finra.org/Industry/Regulation/Notices/2010/P120675.

[2] *Id* at 1.

[3] The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 119 Broker-Dealer member firms that have more than 178,000 affiliated registered representatives serving more than 15 million American households. FSI also has more than 14,000 Financial Advisor members.

In the U.S., approximately 180,000 financial advisors – or approximately 61.7% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.[4] These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[5] Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments on the Proposed Rule

As stated above, FSI has significant concerns with the Proposed Rules because they would provide FINRA with excessively broad authority to request documents and information from firms, impose vague standards of review, and seek to extend FINRA's jurisdiction well beyond its traditional bounds. Our specific concerns on the Proposed Rules are discussed in detail below:

- **Proposed FINRA Rule 1111** – The Proposed Rules seek to provide greater clarity to broker-dealer firms by defining certain terms utilized throughout its provisions. Proposed FINRA Rule 1111 includes these definitions. Among the defined terms is the concept of "control."[6] We are concerned that the proposed definition of this important term fails to provide the clarity desired by broker-dealer firms. This lack of clarity is created by language that necessarily introduces uncertainty and subjectivity. We believe the clarity of the definition would be greatly enhanced by making the following change to its first sentence:

  (d) "control"
  The term "control" means the power to direct or cause the direction of the management or policies of a person whether through ownership of securities or~~,~~ by contract ~~or otherwise~~…

[4] Cerulli Associates at http://www.cerulli.com/.
[5] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.
[6] Proposed Rule 1111(a).

- **Proposed FINRA Rule 1112** – The Proposed Rules seek to streamline the MAP process. Proposed Rule 1112 summarizes the general procedures for that process. Among the procedures contained therein are those involving the means of filing membership applications. Proposed Rule 1112 clarifies that filing an application and supporting documentation via electronic delivery includes delivery by fax, e-mail or a dedicated filing system.[7] In addition, the Proposed Rule clarifies that service by FINRA or filing by a broker-dealer firm via electronic delivery "shall be deemed complete on the date recorded by FINRA's electronic systems for such communication."[8]

  Unfortunately, from time-to-time, FINRA electronic systems have been temporarily unavailable due to system or transmission failure (e.g., TRACE Reporting).[9] These system errors are an unfortunate reality that we believe should be should recognized in the Proposed Rule.

  The Proposed Rule also shortens the period in which an applicant must respond to a written request for information or documents under Proposed Rules 1121 or 1160 from 60 days to 30 days.[10] We believe this timeframe is too short and urge FINRA to provide applicants with the same period the Proposed Rules would allow FINRA to issue a written decision on a CMA.

  Finally, the Proposed Rule would also lapse an application should the applicant fail to schedule within 30 days of filings its Form NMA or application pursuant to Proposed Rule 1160 all qualification examinations required of Associated Persons of the applicant and/or successfully complete such examinations within 120 days of filing.[11] Unfortunately, this section of the proposal does not address the timeframe in which exam waiver requests would be permissible.

  Because of the foregoing comments, we recommend the following changes to Proposed Rule 1112:

  > Section 1112(a)(4)(D)
  > Service or filing by electronic delivery shall be deemed complete on the date recorded by FINRA's electronic systems for such communications or, should such systems be unavailable due to system or transmission error, on the date submission was first attempted by the Applicant.
  >
  > Section 1112(b)(1)
  > Absent a showing of good cause, an application filed under Rule 1121 or 1160 shall lapse if an Applicant fails to:
  >
  > (A) respond fully within ~~30~~45 days after service of an initial or subsequent written request for information or documents under Rules 1121 or 1160, or within such other time period agreed to by the Department and the Applicant;

[7] Proposed Rule 1112(a)(2).
[8] Proposed Rule 1112(a)(4)(D).
[9] See at http://www.finra.org/Industry/Compliance/MarketTransparency/TRACE/SystemStatus/.
[10] Proposed Rule 1112(b)(1)(A).
[11] Proposed Rule 1112(b)(1)(D)(i) through (E)(ii).

Section 1112(b)(1)
(D) (i) schedule or file, within 30 days of filing its Form NMA, all qualification examinations or waiver requests required of Associated Persons of the Applicant in order for the Applicant to conduct its intended business; and
(ii) ensure that such Associated Persons successfully complete their required qualification examinations or are granted a waiver within 120 days of filing; or
(E) (i) schedule or file, within 30 days of filing an application pursuant to Rule 1160, all qualification examinations or waiver requests required of Associated Persons of the Applicant in order for the Applicant to commence its proposed change in ownership, control, or business operations; and
(ii) ensure that such Associated Persons successfully complete their required qualification examinations or are granted a waiver within 120 days of filing.

- **Proposed FINRA Rule 1121** – The Proposed Rules would require applicants to provide information regarding its affiliate relationships.[12] Proposed Rule 1121 would require a brief summary of each affiliate's principal business activity and the legal relationship between the applicant and each affiliate.[13] The Proposed Rule would also require "a detailed and comprehensive summary of the business relationship between the Applicant and any Affiliate" that meet certain specified criteria.[14] These changes are intended to ensure FINRA has access to all of the relevant aspects of an applicant's business that are within the scope of its statutory authority.[15]

  We have three general concerns with these proposed changes. First, we believe the criteria that trigger the detailed reporting requirements are too broad. Second, we are concerned that the Proposed Rule fails to provide guidance to applicants as to the content of the required "detailed and comprehensive summary" allowing FINRA free reign to require any information it deems fit. Finally, FINRA appears to be expanding its jurisdiction beyond its traditional bounds by involving itself in a deep review of affiliate business activities. The expansive triggering criteria, open-ended documentation requirements, and expansion of jurisdiction would allow FINRA to engage in unnecessary and burdensome "fishing expeditions" into the details of an applicant's affiliate relationships. We believe that narrower criteria, more specific documentation requirements, and recognition of the limits of FINRA's jurisdiction would alleviate these concerns.

  More specifically, we have the following concerns:

  - Section 1121(a)(1)(F)(v)a. would require a detailed and comprehensive summary of the business relationship between the applicant and any affiliate whose financial information is consolidated with that of the Applicant. We seek clarification as to whether this requirement would obligate an applicant firm to provide the required information for every affiliate listed in their 10-K filing? If so, we find the requirement too broad and urge FINRA to confine their review to affiliates that offer investment products and services.
  - Section 1121(a)(1)(F)(v)g. would require a detailed and comprehensive summary of the business relationship between the applicant and any affiliate

[12] RN 10-01 at 9.
[13] Proposed Rule 1121(a)(1)(G)(iv).
[14] Proposed Rule 1121(a)(1)(G)(v)a. through h.
[15] RN 10-01 at 10.

that has a marketing relationship with the applicant. We believe this requirement is unduly burdensome for large fully integrated firms. We recommend that the criteria be limited to marketing relationships involving investment products and services.

- Section 1121(a)(1)(F)(vi) would give FINRA discretion to require "evidence of, and information regarding, any business relationship disclosed pursuant" to Section 1121(a)(1)(G)(v). This requirement is overly broad, unduly burdensome, and without a clear connection to investor protection concerns. We urge FINRA to remove this provision or provide a meaningful justification for its inclusion in the Proposed Rule.
- In an effort to distinguish the Proposed Rule from similar NYSE requirements, page 11 of RN 10-01 includes the following statement: "Further, self-regulatory organizations (SROs) previously have required member firms to provide affiliate information. For instance, NYSE Rule 304(e) (Allied Members and Approved Persons) requires persons that control a member organization, or that are engaged in a securities or kindred business and are controlled by or under common control with a member organization (namely, affiliates), become approved persons, thus subjecting them to the jurisdiction of the NYSE. Such entities are often not otherwise subject to the NYSE's regulatory authority. Unlike NYSE Rule 304, proposed FINRA Rule 1121 does not require affiliates of a firm to consent to FINRA's jurisdiction." (emphasis added) We believe this statement demonstrates that FINRA is aware that the Proposed Rule's requirements for information about affiliates go beyond the traditional bounds of their jurisdiction. If, as FINRA appears to acknowledge, certain affiliate activities are beyond its jurisdiction, then FINRA should not seek to obtain information and documentation about these affiliates. We urge FINRA to limit its inquiries into the activities of those affiliates that offer investment products and services.

- **Proposed FINRA Rule 1130** – The Proposed Rules would alter to the criteria that form the basis of FINRA decisions about applications.[16] Proposed Rule 1130 lists the review criteria. FSI has concerns about the following proposed changes to these criteria:

  - Section 1130(a)(3) would require applicants to fully disclose and establish through documentation all sources of their funding. It would also require FINRA to determine that such sources of funding "are not objectionable." We find this unreasonable in that it provides FINRA free license to deem funding sources "objectionable" without reference to objective criteria. We recommend that FINRA adopt the following language in its place:

    3) The Applicant has fully disclosed and established through documentation satisfactory to FINRA all sources of its funding, and FINRA has determined that such sources of funding are ~~not objectionable~~ consistent with a member firm's obligations under Rule 2010.

  - Section 1130(a)(8)(D) would allow FINRA to impose higher net capital requirements for applicants that are involved in the investment advisor business. Neither the Proposed Rule nor RN 10-01 provides justification for

[16] RN 10-01 at 12.

this new authority. However, we assume that FINRA believes the financial criteria for registered investment advisers is insufficient and, therefore, should be supplemented by broker-dealer net capital when possible. While there may be merit to this conclusion, we believe it is improper for FINRA to address its concerns in this manner. Instead, FINRA should bring its concerns to the SEC and state securities administrators in an effort to develop uniform net capital requirements for all investment advisors rather than arbitrarily impose heightened requirements for some. We urge FINRA to drop this language from the Proposed Rule.

- Section 1130(a)(4) would allow FINRA to take into consideration an affiliate's disciplinary history when considering whether the applicant and its associated persons are capable of complying with federal securities laws, the rules and regulations, and FINRA rules. We do not understand the relevance of this information to the MAP process. After all, the affiliate has clearly been held accountable by its own regulator. Allowing FINRA to impose additional sanctions through the MAP appears to duplicate these efforts. In addition, it suggests that FINRA will assume that an affiliates past behavior is predictive of the applicant and the applicant's associated persons future behavior. We believe this is unreasonable and ask FINRA to eliminate the review of affiliate disciplinary history from the Proposed Rule.

- **Proposed FINRA Rule 1170** – The Proposed Rules would require broker-dealers to provide FINRA with timely written notice should certain events occur.[17] These events are listed in Proposed Rule 1170.

  In general, we are concerned that the written notice requirement for many of the listed events duplicates information already included in Form BD. In addition, we believe other criteria listed in the Proposed Rule require additional explanation and clarity. Our specific concerns are outlined below:

  - Section 1170(a)(1) would require the timely reporting of direct or indirect acquisitions or divestitures of 10% or more of the broker-dealer's assets or any asset that generates revenues comprising 10% or more of the broker-dealer's revenues measured on a rolling 36-month basis. We believe this requirement sets the threshold too low, obligates firms to perform an unreasonably difficult calculation in order to insure compliance, and provides no clear investor protection benefit. We recommend that the elimination of this reporting criteria.
  - Section 1170(a)(3) would require the timely reporting of the "[a]ddition, removal, or substantial modification of a business relationship between a broker-dealer and an affiliate requiring disclosure pursuant to Rule 1121(a)(1)G)(v)a. through h…" Broker-dealer firms are already required to disclose this information on Form BD. FINRA should not obligate firms to provide duplicate filings of this information. We recommend that FINRA remove this reporting criteria from the Proposed Rule.
  - Section 1170(a)(4) would require the timely reporting of "[a] change or loss of the member's key personnel, such as its Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Compliance Officer, or any individual with similar status or functions…" Broker-dealer firms are already

[17] RN 10-01 at 18.

required to disclose this information on Form BD. FINRA should not obligate firms to provide duplicate filings of this information. We recommend that FINRA remove this reporting criteria from the Proposed Rule.

- Section 1170(a)(9) would require the timely reporting of the listing of the broker-dealer on any facility designed to solicit offers with respect to the possible purchase of the firm in whole or in part or the transfer of some or all of the firm's assets. We believe the reporting of this information is in appropriate. FINRA will be notified of any change in ownership at the proper time. We believe prior reporting is premature and provides no demonstrable investor protection.
- Section 1170(b) would allow FINRA to require a submission of a Continuing Membership Application if it determines that the reported event will substantively affect the business or resources of the member. We urge FINRA to more specifically define the criteria that would require the submission of a Continuing Membership Application so that broker-dealer firms can plan their activities with a full of understanding of their obligations under FINRA rules.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to improve and streamline the membership application process.

Thank you for your consideration of our comments. Should you have any questions, please contact me at (202) 379-0943.

Respectfully submitted,

Dale E. Brown, CAE
President & CEO