Membership Application Rules and Processes

MARCH 2016

I. Introduction

A. Purpose and Structure of Review

FINRA is conducting a retrospective review of the NASD Rule 1010 Series (Membership Proceedings) (collectively, MAP rules), which govern FINRA's Membership Application Program (MAP).[1] The purpose of the review is to assess whether the rules are meeting their intended investor protection objectives by reasonably efficient means and to take steps to maintain or improve the effectiveness of the rules while minimizing negative economic impacts. The review is part of an ongoing initiative launched in April 2014 to periodically look back at significant groups of rules to ensure they remain relevant and appropriately designed to achieve their objectives, particularly in light of industry and market changes.

FINRA has separated the review into an assessment phase and an action phase. During the assessment phase, which is the focus of this report, the staff analyzed the effectiveness and efficiency of the MAP rules as currently implemented. The assessment encompassed not only the substance and application of the rules, but also FINRA's processes to administer them.

In the ensuing action phase, FINRA staff intends to consider specific rule proposals or other initiatives resulting from the assessment phase. FINRA will engage in its usual rulemaking process to propose any amendments to the rules based on the assessment.

B. Assessment Process

The staff followed an extensive, multi-step assessment process. The process afforded stakeholders the opportunity to share their experiences with, and opinions of, the MAP rules and processes and included multiple avenues of feedback from the industry. The staff initially looked back through the comments received to an earlier proposal in *Regulatory Notice 13-29* to transfer the MAP rules into the Consolidated FINRA Rulebook. The staff then solicited broad and diverse views through issuance of *Regulatory Notice 15-10* requesting comment on the effectiveness and efficiency of the MAP rules. The *Notice* explained the review process and asked the following questions with respect to the rules:

- Have the rules effectively addressed the problem(s) they were intended to mitigate?
- What have been experiences with implementation of the rule set, including any ambiguities in the rules or challenges to comply with them?
- What have been the costs and benefits arising from FINRA's rules? Have the costs and benefits been in line with expectations described in the rulemaking?
- Can FINRA make the rules more efficient and effective, including FINRA's administrative processes?

FINRA received four comments in response to the *Notice*.

In addition, FINRA staff spoke directly with firms and various non-member firms that often assist members with MAP submissions. The staff conducted interviews with these external stakeholders representing a cross-section of firm sizes and business models, and diverse viewpoints and experiences with the rules.

During these discussions, FINRA staff invited candid feedback as to which rules are working effectively and efficiently and which are not. The staff expressly sought feedback on the specific provisions or processes that could be improved and endeavored to understand why a rule or provision is not working—for example, lack of clear standards, excessive costs relative to the protection afforded investors, or failure to keep up with technological or market changes. The staff asked the external stakeholders to identify particular "pain points" in the implementation and administration of the rules and to provide details or examples as to how the rules are impacting their businesses, the markets and investors. The staff also inquired about any regulatory gaps that may exist with the rules, emphasizing that investor protection remains FINRA's paramount concern.

The staff integrated the views expressed in the interviews and the comments received to the *Notice*, as well as comments to *Regulatory Notice 13-29*, into a thematic summary. The staff validated the thematic summary with a broader group of stakeholders, including FINRA advisory committees and one interested trade organization.

The thematic summary of the views also informed another critical step in the validation process: the development of a survey that was distributed to all FINRA member firms and various non-member firms that often assist members with MAP submissions. The survey tested the views that emerged during the comment and interview process, and permitted respondents to identify potentially missing points of view. The survey included general questions about the respondent's size, business model and degree of engagement with the MAP rules to illuminate correlations that could benefit the assessment. The survey also included free text sections to allow respondents to identify issues that may not have been captured by the themes or amplify answers to questions. The survey responses are discussed in Section IV below.

The staff also sought the experiences of FINRA's internal operating departments including the MAP Group that work with the rules. During this assessment, the MAP Group noted the enhancements it has made over the last few years to improve the efficiency of the review process, most notably the MAP Triage Program, which was launched in 2013. Under this program, the Triage Group evaluates the risk, complexity, regulatory significance, completeness, scale and scope of all applications and other membership-related matters to determine whether the matter is eligible for expedited (*i.e.*, Fast Track) or full review. The Triage Program has significantly reduced processing times for all applications and other membership-related matters. Communication is another aspect that has been improved. Specifically, a manager of the MAP Group is required to periodically contact an applicant to provide a status of an application and address any questions the applicant may have. In addition, prior to the launch of the Triage Program, the MAP Group centralized its review processes into a single office and implemented online application forms to increase consistency and efficiency.

II. Background, Objectives and Administration of the Rules

The MAP rules are intended to promote investor protection by applying uniform standards for admission to FINRA as a member firm and for review of changes to a current member firm's ownership, control or business operations. The MAP rules provide a means for FINRA, through the Department of Member Regulation's MAP Group, to assess the proposed business activities of its potential and current member firms. The MAP Group evaluates an applicant's financial, operational, supervisory and compliance systems to ensure that each applicant meets the standards set forth in NASD Rule 1014, and the application and all supporting documents appear consistent with the federal securities laws, the rules and regulations thereunder, and FINRA rules. The MAP rules require applicants to demonstrate their ability to comply with rules and laws including observing high standards of commercial honor and just and equitable principles of trade applicable to their business. In addition, among other requirements, the MAP rules require consideration of whether persons associated with an applicant have disciplinary actions taken against them by other industry authorities, customer complaints, adverse arbitrations, pending or unadjudicated matters, civil actions, remedial actions imposed, or other industry-related matters that could pose a threat to public investors.

The MAP rules require the filing of two distinct types of applications: (1) a New Member Application (NMA) filed by an applicant seeking membership in FINRA; and (2) a Continuing Membership Application (CMA) filed by a member firm seeking approval to expand its operations or activities, and for other business events listed in NASD Rule 1017.

A. NMA Process

1. The NMA and Interview (NASD Rule 1013)

NASD Rule 1013 sets forth the requirements for a new member application, including how to file, the documents that applicants must submit, the ability of the MAP Group to request additional documentation and to reject an application that is "not substantially complete," and the process for conducting membership interviews. To start the new membership process, FINRA requires an applicant to reserve a broker-dealer name, fund its general account, then submit to FINRA the required hardcopy forms such as a notarized Form BD, a form requesting access to the FINRA Firm Gateway, an email notification contact form, and a new member assessment report. Once FINRA has processed these hardcopy forms and the applicant has paid the requisite fee, the applicant can access the Central Registration Depository (Web CRD®) System (via FINRA Firm Gateway) to submit Forms U4 and BR, amend Form BD as needed, and complete Form NMA.

FINRA is required to process an NMA within 180 calendar days from the date FINRA receives a substantially complete application for membership (or longer as agreed to between FINRA and the applicant). Where the application for membership is deemed "not substantially complete," FINRA will provide the applicant additional time to correct the deficiencies and if not completed within the allotted timeframe, the MAP Group staff will reject the application and deem it not to have been filed. The MAP Group staff will send the applicant a written notification of that determination along with the reasons therefor.

Under NASD Rule 1013, an applicant filing for new membership with FINRA has 60 calendar days to respond to the MAP Group staff's initial request for information, and must respond within 30 calendar days of any subsequent requests. If the applicant does not meet the deadlines, the application will lapse and the applicant must start the process anew. If the applicant wishes to continue to seek membership, the applicant must submit a new application and related fees. The rule provides that if an applicant withdraws an application within 30 calendar days after filing the application, FINRA will refund the application fee, less a processing fee. If the applicant determines to again seek membership, the applicant must submit a new application and pay the requisite fee.

2. Standards for Admission (NASD Rule 1014)

NASD Rule 1014 sets forth the standards for admission, the process and timing for granting or denying an application, the timing and content requirements for the MAP Group's decision and submission of a membership agreement, and the effectiveness of restrictions in the membership agreement. The MAP Group considers, as a whole, the applicant's business plan, information and documents the applicant submits under NASD rule requirements, information the applicant provides during the membership interview, as well as information the MAP Group obtains. The MAP Group evaluates all applications to determine whether the applicant meets the 14 standards or criteria set forth in NASD Rule 1014.

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

3. Membership Interview (NASD Rule 1013(b))

A new member applicant is required to have a membership interview that includes the MAP Group staff processing the application, staff from one of the Member Regulation Department District Offices who will be assigned to the applicant if the application is approved, and the primary persons who will own, control and manage the applicant, along with the applicant's consultant(s) or attorney(s), if any. For an NMA, the membership interview is a required component in the MAP review process. The interview enables the MAP Group to meet the primary persons who control the applicant and to identify issues needing resolution.

B. CMA Process

1. Change in Ownership, Control or Business Operations (NASD Rules 1017(a) and 1017(c))

NASD Rule 1017 provides that certain changes in a member firm's ownership, control or business operations require a CMA. Specifically, events that require a firm to file a CMA are:

- a merger of the member with another member, unless both are members of the New York Stock Exchange (NYSE) or the surviving entity will continue to be a member of the NYSE;
- a direct or indirect acquisition by the member of another member, unless the acquiring member is a member of the NYSE;
- direct or indirect acquisitions or transfers of 25 percent or more in the aggregate of the member's assets or any asset, business or line of operation that generates revenues composing 25 percent or more in the aggregate of the member's earnings measured on a rolling 36-month basis, unless both the seller and acquirer are members of the NYSE;
- a change in the equity ownership or partnership capital of the member that results in one person or entity directly or indirectly owning or controlling 25 percent or more of the equity or partnership capital; or
- a material change in business operations as defined in NASD Rule 1011(k). The term "material change in business operations" includes, but is not limited to: (1) removing or modifying a membership agreement restriction; (2) market making, underwriting or acting as a dealer for the first time; and (3) adding business activities that require a higher minimum net capital under Rule 15c3-1 of the Securities Exchange Act.

2. Application Review

Depending on the nature of the application (*e.g.*, to expand business operations or remove or modify restrictions), a member firm may be required to provide additional information and documentation to support the application. Such additional information and documentation may include an amended Form BD, and description of the proposed business activities, supervisory personnel, supervisory and compliance procedures, net capital and source of funds, and an explanation for why any restriction(s) should be modified or removed. As with an NMA, a CMA will be assessed against the standards in NASD Rule 1014. In addition, similar to an NMA, before the MAP review process may begin for a CMA, the application must be deemed "substantially complete." For a CMA, the MAP review period (180 calendar days or longer as agreed to between FINRA and the applicant) starts on the date an applicant submits a "substantially complete" Form CMA. The MAP Group is not required to, but may conduct a membership interview for a CMA. If circumstances warrant, the MAP Group will grant the application. In every case, the MAP Group must issue a written decision providing a detailed rationale.

3. CMA Fee Waiver

A CMA is subject to an application fee under Section 4(i) of Schedule A to the FINRA By-Laws, but the fee may be waived if FINRA determines that the CMA is proposing less significant changes that do not require substantial MAP Group staff review. Section 4(i) of Schedule A provides examples of circumstances under which a CMA may qualify for a fee waiver:

- The proposed change does not make any day-to-day changes in the applicant's business activities, management, supervision, assets or liabilities, and the applicant is only proposing a change in the applicant's legal structure (*e.g.*, corporation to limited liability company), ownership structure (*e.g.*, adding a holding company), or change of percentage ownership of existing owners with no disclosure or disciplinary issues in the preceding five years.

- The application is filed in connection with a direct or indirect acquisition or transfer of 25 percent or more in the aggregate of the applicant's assets or any asset, business or line of operation that generates revenues composing 25 percent or more in the aggregate of the applicant's earnings measured on a rolling 36-month basis where the applicant is also ceasing operations as a broker or dealer (including filing a Form BDW with the SEC) and there are no pending or unpaid settled customer-related claims, or there are claims but the applicant demonstrates in the CMA its ability to satisfy in full any unpaid claims (*e.g.*, sufficient capital or escrow funds, proof of adequate insurance for customer-related claims).

Other proposed changes in ownership, control or business operations also may qualify for a fee waiver where FINRA determines that the application is proposing less significant changes that do not require substantial review by the MAP Group. An applicant may contact FINRA prior to filing a CMA to discuss whether a proposed change in business operations might qualify for a fee waiver.

4. Materiality Consultation

When a member firm contemplates a change in business operations that may not squarely fall within one of the categories or definitions that would require a CMA, a member firm may seek guidance to determine how best to proceed with the proposed change by voluntarily seeking a materiality consultation from the MAP Group staff. A request for a materiality consultation is a written request from a member firm for a determination from the MAP Group of whether a proposed change is material, which would then require the member firm to file a CMA. The characterization of a proposed change as material depends on an assessment of all the relevant facts and circumstances. The MAP Group may communicate with the member firm to obtain further information regarding the proposed change and its anticipated impact on the firm. Where the proposed change is material, the MAP Group will instruct the member firm to file a CMA if it intends to proceed and will advise that effecting the change without approval would constitute a violation of NASD Rule 1017.

C. Decision by the MAP Group (NASD Rules 1014 and 1017)

Under Rule 1014, the MAP Group determines whether an applicant meets all of the requisite standards for admission to FINRA and serves the applicant with a written decision. Under Rule 1017, the MAP Group considers applications for approval of change in ownership, control or business operations and renders a written decision. In addition, the rules address: (1) the applicable timeframe and required content of the MAP Group's decision and the applicant's right to file a written request for review if the MAP Group fails to serve a timely decision; (2) the applicant's requirement to file an executed membership agreement if the MAP Group grants an application; (3) the MAP Group's requirement to serve its decision and membership agreement on the applicant; (4) the effectiveness of a membership agreement restriction unless removed, modified or stayed by the National Adjudicatory Council (NAC), FINRA Board of Governors or the Securities and Exchange Commission (SEC); and (5) the MAP Group's decision constituting FINRA's final action unless the applicant files a written request for review.

D. Appeal Process (NASD Rules 1015, 1016 and 1019)

NASD Rule 1015 (Review by National Adjudicatory Council) permits an applicant to submit a request for review by the NAC of an adverse decision rendered on a NMA or CMA. NASD Rule 1016 (Discretionary Review by FINRA Board) also permits a governor of the FINRA Board to call for a discretionary review of a membership proceeding. Finally, a person aggrieved by final action of FINRA under the NASD Rule 1010 Series may apply for review by the SEC pursuant to NASD Rule 1019 (Application to Commission for Review). Collectively, these rules provide for the

administration of the MAP appeals process and, among other things, set forth specified time periods for holding hearings and satisfying document production requests, the evidence and testimony that may be considered, and the nature of information required to be provided by FINRA to the applicant.

III. Stakeholder Views

After considering the viewpoints expressed during the retrospective rule review interview and comment process, the staff identified the following common themes:

- **General Observations:** Most responding external stakeholders agreed that the MAP rules have been effective at addressing their intended investor-protection objectives. However, the stakeholders also identified areas where they believed the investor protection objectives and economic impacts could better align or where the rules could be made more effective or efficient.
- **Align Review and Approval Process With Risk Presented by an NMA or CMA:** Many of the stakeholders asserted that while the MAP rules effectively serve to protect investors, the rules and application review process should be tailored based on a firm's types of business by identifying activities that may warrant a more streamlined or simplified application process for engaging in certain business lines (*e.g.*, private placements). They stated that a "one-size-fits-all" approach set forth in the MAP rules imposes significant direct and indirect costs on firms and potentially diverts FINRA resources from higher risk matters. Many of the firms suggested that a risk-based approach under the MAP rules and application review processes would be a better use of both firm and FINRA resources. Many of the stakeholders supported the new Fast Track review process implemented by the MAP Group to expedite processing of certain types of applications. They asserted a need for clarity on the matters that would be eligible for such expedited processing, and greater transparency regarding how the MAP Group determines the scope and depth of the review of an application undergoing a Fast Track review. They further asserted the need to provide greater interpretive flexibility in reading the restrictions and approved business lines in a membership agreement to permit member firms to expand their operations without a need for a CMA in every instance.
- **Amend or Clarify Standards for Admission and Definitions:** Most of the responding stakeholders asserted that the requirement to apply all 14 of the current standards to all applications leads to challenges to specific business models. Some of the stakeholders noted that some of the 14 standards do not reflect current industry business environment and practices (*e.g.*, office space, leases, source of funding) and suggested that FINRA conduct risk-based reviews of applications by applying only the standards that are relevant to a specific application versus the current practice of reviewing an application against all 14 standards. Some stakeholders noted the need to give the MAP Group discretion to apply relevant standards based on the risks presented by an application. Several stakeholders also commented on the lack of understanding of the term "not substantially complete" for purposes of rejecting an application.
- **Clarify the Meaning of "Material" to Better Identify Events That Require a CMA:** Many of the stakeholders asserted that the definition of a "material change in business operations" as used in the MAP rules is ambiguous and leads to confusion on when a firm needs to file an application with the MAP Group. To that end, several stakeholders suggested that FINRA codify and update guidance in *Notice to Members 00-73* and subsequent *Notices*. Stakeholders suggested that FINRA clarify when a firm should seek a materiality consultation from the MAP Group to determine whether a proposed change is material. Stakeholders also said that more guidance is necessary on the application of the 25 percent threshold to changes in ownership

or control, and the circumstances under which a firm must apply for *approval of a change in ownership or control at least 30 days prior to the change taking effect* (while the applicant may effect the change prior to the conclusion of the MAP Group staff's decision on the application, the MAP Group staff may place interim restrictions on the applicant based on the standards of admission pending a final decision) versus when a firm must file an application for *approval of a change in ownership, control or business operations before such change can occur*. These stakeholders also encouraged FINRA to provide more guidance on the nature and scope of potential interim restrictions and the safe harbor for business expansions. Some stakeholders further requested that FINRA work in coordination with SEC staff to update business categories currently provided on the SEC's Form BD.

- **Update Systems and Technology/Electronic Forms:** Most of the responding stakeholders asserted that technology improvements would significantly help to make the filing, tracking of applications and the submission of supporting documentation more efficient.
- **Improve Efficiency of Review Process, Staff Communication and Training:** While stakeholders commended the professionalism and responsiveness of the MAP Group staff, they believed that the administration of the rules could be improved in several ways, including better communication, streamlining requests for additional information or more effective use of information already in FINRA's possession. In addition, some stakeholders suggested that review of applications by MAP Group staff be allocated based on staff experience and expertise (*e.g.*, create teams with specialized knowledge of different business types).

The advisory committees and an interested trade organization largely validated the thematic summary of views. However, as discussed below, the survey results did not yield particularly strong views about the MAP rules or processes.

IV. Survey

The staff developed a survey of member firms and non-member firms as a method to collect broad feedback on the observations provided through comment letters, and interviews and other discussions with external stakeholders. It served as a method to corroborate or invalidate the primary concerns expressed regarding the MAP rules and to identify other possible issues not captured in the interviews or by the comment letters. The survey solicited responses to questions regarding the effectiveness of the current regulatory regime, the priorities for updating the existing rules and the related interpretations and guidance, and processes and systems, and the costs and burdens associated with the current rules and potential alternatives.

The member firm survey was sent to all FINRA member firms, approximately 3,900 firms, of which 590 either partially or fully completed the survey. The non-member firm survey was sent to 67 non-member firms, of which 10 partially or fully completed the survey. The survey data are self-reported and thus may not be completely consistent with MAP's statistics.

A. Summary of Survey Responses

The survey responses generally provide weak evidence with respect to the views expressed during the interview and comment process. Many respondents are agnostic about aspects of the MAP rules and processes as put forward in the survey instrument, potentially due to the lack of recent experience. Respondents with more recent experience with the MAP rules and processes are less likely to be neutral on their effectiveness and efficiency. These respondents tend to report both more positive and more negative responses than other respondents. Survey respondents, especially respondents with recent experience, generally agree that:

- In general, the MAP rules and published guidance regarding the NMA and CMA processes are effective and efficient.
- The materiality consultation process is effective in helping firms to determine whether a CMA is required.
- The expedited (*i.e.*, Fast Track) review effectively achieves its intended goal of identifying low-risk and low-complexity matters and reducing the processing time.
- The timeliness of the review process could be improved.

The survey evidence does not lead to similar conclusions with the views of the external stakeholders on several issues. For instance:

- External stakeholders asserted a need for clarity on the matters that would be eligible for expedited processing. Member firm survey respondents do not have a strong view on the issue, with only 11 percent disagreeing that FINRA's published guidance is clear on what matters are eligible for expedited review. While 36 percent of the respondents agree with the statement, the remaining respondents are neutral.
- Most external stakeholders asserted that the current 14 standards that all applications must satisfy lead to challenges in the application of these standards to specific business models. In the survey, for each of the 14 standards, between 76 percent and 91 percent of the member firm respondents believe that the standard is clear and applicable and should be maintained. Respondents expressed this sentiment more strongly with respect to the NMA process than to the CMA process.
- Many external stakeholders asserted that the definition of a "material change in business operations" as used in the MAP rules is ambiguous. Approximately 70 percent of member firm survey respondents think that FINRA's rules and published guidance on what constitutes a "material change in business operations" are clear.
- Some external stakeholders suggested there was an opportunity to strengthen staff communication with applicants. According to the survey responses, the vast majority of the member firms that filed NMA or CMA within the last three years believe that the communication with FINRA staff is effective and efficient.
- Most external stakeholders recommended that FINRA improve the MAP technology platform. The survey responses indicate less strong and consistent opinions. For example, only 8 percent of member firm survey respondents disagree with the statement that the technology platform is easy to navigate and use, while 37 percent of the respondents agree and 55 percent are neutral. Less than a quarter of member firm respondents believe that the technology aspect of the NMA and CMA rules and processes may be made more effective and efficient, placing technology in the middle of their concerns.

In addition, the survey responses indicate that the economic impacts associated with MAP rules and processes are material. For example, 40 percent of member firm survey respondents agree that MAP rules and processes are a barrier to entry to becoming a broker-dealer or discourage firms from expanding into new lines of business. About 33 percent of the respondents agree that MAP rules and processes create disruption in business planning for firms. Respondents did not clearly identify specific sources of the frictions associated with the MAP program or provide strong indications of where improvements might be made to lower the frictions without reducing investor protections.

The staff's analysis of key themes in the responses is set forth below.

B. Characteristics of Member Firm Respondents

Most responding member firms described their business as "broker or dealer retailing equity or fixed income securities" (37 percent) and "private placements of securities" (38 percent), which is consistent with the general population of FINRA members for which the top business categories are "private placement of securities" (62 percent), "mutual fund retailer" (45 percent), "broker or dealer retailing corporate equity securities over-the-counter" (43 percent) and "broker or dealer selling corporate debt securities" (39 percent).[4,5] About half of the survey respondents have institutional customers only. Approximately 89 percent of the respondents reported having 150 or fewer registered persons and, therefore, are classified as small firms by the FINRA By-Laws definition.[6] The proportion of small firms is approximately the same as that of the general population of FINRA members (90 percent).

C. Analysis of Survey Responses

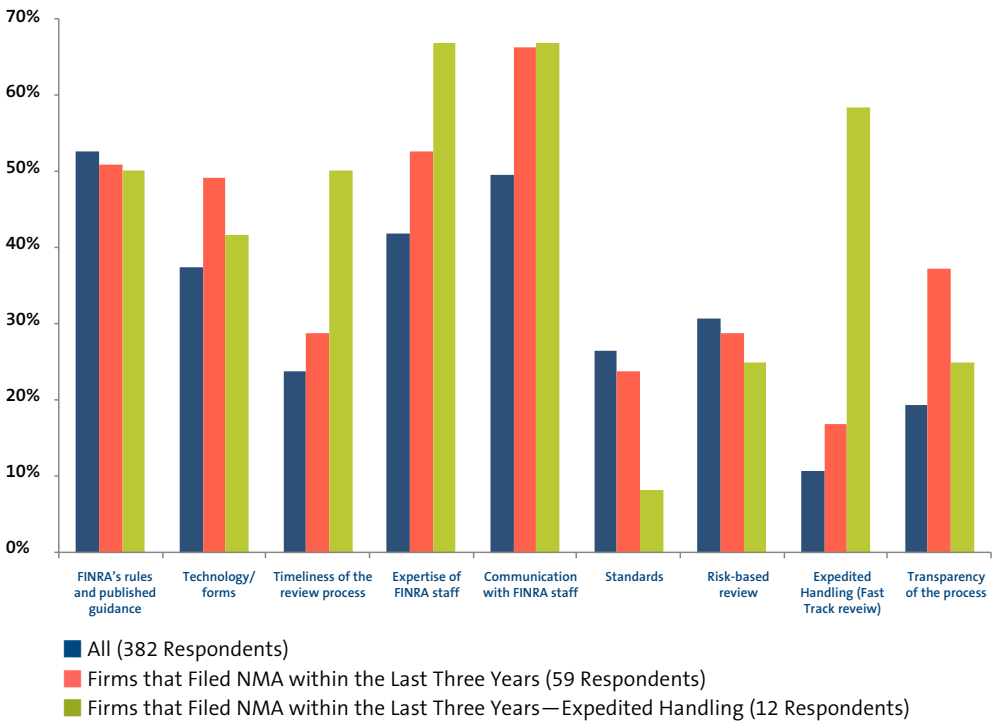
1. Experience With the Rules

- NMA

The vast majority of member firm respondents filed their NMAs more than three years ago. Approximately 12 percent of the respondents indicated that they filed their NMAs within the last three years. Among these firms, 14 firms had NMAs that underwent expedited review. These characteristics suggest that most respondents did not have direct experience with the process improvements implemented by the MAP Group staff in this area in the last three years. Indeed, many respondents stated that it had been decades since their NMA filing and thus they had no recollection of the experience.

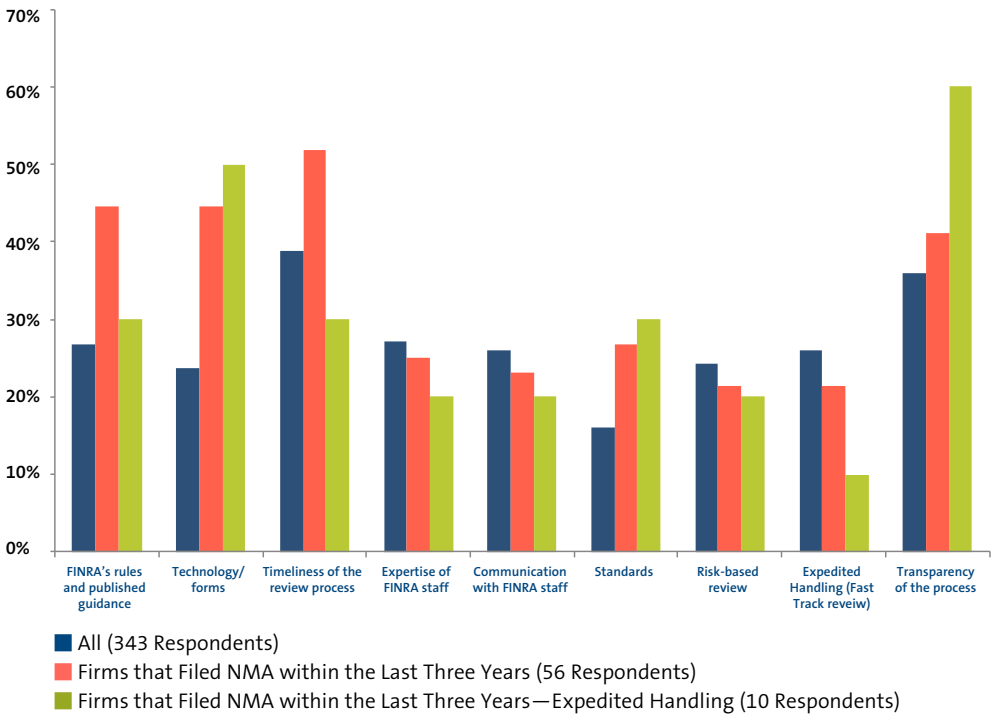
Notwithstanding respondents' lack of recent experience, Figure 1 shows that over half of the respondents believe that the current FINRA rules and published guidance regarding the NMA process are effective and efficient. Other areas that are commonly considered effective and efficient are the communication with FINRA staff and the expertise of FINRA staff. These two areas also received more positive feedback from firms that filed NMAs within the last three years, indicating member recognition of the process improvements. The majority of the firms whose NMA filings underwent expedited review provided positive feedback on the process.

Figure 1: Effective and Efficient Areas of Current NMA Rules and Processes



As Figure 2 shows below, about 39 percent of the respondents believe that the timeliness of the NMA review process could be improved and about 36 percent of the respondents believe that the transparency of the NMA process could be enhanced. Among the firms that filed NMAs within the last three years, a higher proportion of respondents agree that FINRA's rules and published guidance and the 14 standards for admission could be made more effective and efficient. Respondents with more recent experiences tended to report both more positive and more negative responses with respect to the efficiency and efficacy of technology and transparency than other respondents. This may be explained that firms that went through the process recently are more likely to form an opinion on the subjects one way or another, while firms that filed NMAs many years ago may have less strong recollection of their experience. It is interesting to note that respondents with expedited handling reported results that were mixed compared to other recent NMA filers, but note that the sample size is small (only 10 respondents), and therefore it is difficult to draw strong conclusions from these results.

Figure 2: Areas of Current NMA Rules and Processes That May Be Made More Effective and Efficient



Out of the 10 non-member firm respondents, most firms helped file less than five NMAs within the last three years, and only one respondent worked on more than 10 filings. Given the small sample size and the limited interaction with the rules or processes of the non-member firms, this report draws limited inferences from the responses. Nonetheless, five out of seven respondents believe that FINRA's rules and published guidance are effective and efficient, and five out of seven respondents think the technology/forms aspect of the NMA process may be enhanced. Four respondents believe that the expertise of FINRA staff and the risk-based review could be improved. In general, compared to member firm respondents, the non-member firm respondents are less positive about the efficiency and effectiveness of the NMA rules and processes.

- CMA

Roughly half of member firm respondents indicated that they had filed CMAs, 56 percent of which filed their most recent CMA within the last three years. About 25 percent of the respondents that filed CMAs within the last three years underwent the expedited review process.

Figure 3 indicates that overall, the respondents' experience with the CMA process appears to be similar to that with the NMA process. More than 40 percent of the respondents consider the current FINRA rules and guidance regarding the CMA process to be effective and efficient, while roughly 30 percent of the respondents, as shown in Figure 4, believe the timeliness of the CMA review process may be improved. All areas received both more positive and more negative responses from firms with CMA filings within the last three years. In general, firms that underwent expedited CMA review provided more positive and less neutral or negative feedback on the questions of overall efficiency and effectiveness than both firms with recent non-expedited CMAs and older CMAs, indicating an effective Fast Track program.

Figure 3: Effective and Efficient Areas of Current CMA Rules and Processes

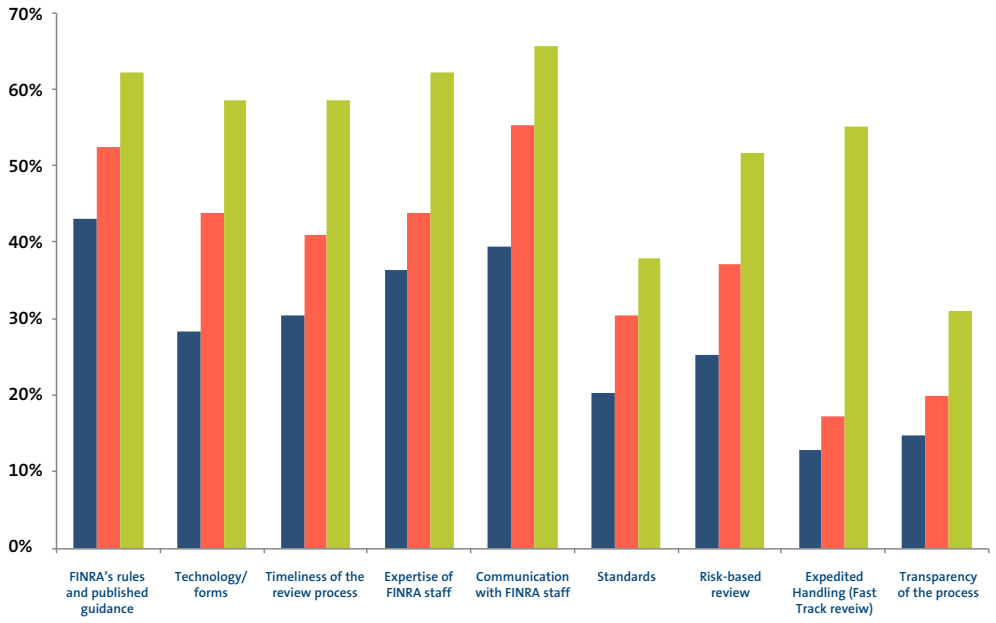
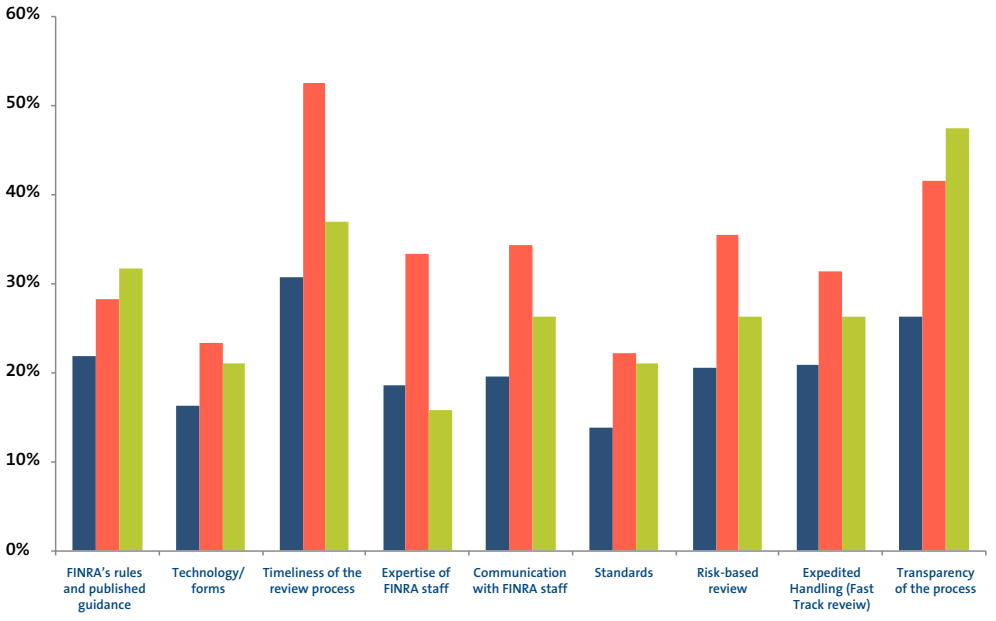


Figure 4: Areas of Current CMA Rules and Processes That May Be Made More Effective and Efficient



Similar to the NMA survey results, few non-member firm respondents had extensive experience with CMA filings in recent years. Five out of six non-member firm respondents believe that the communication with FINRA staff is effective and efficient, and half of the respondents provided positive feedback on FINRA's rules and published guidance and the expertise of FINRA staff. On the other hand, three out of six respondents believe that FINRA's rules and published guidance, the timeliness of the review process, and the risk-based review could be improved.

- Materiality Consultations

Approximately 22 percent of member firm respondents indicated that they sought materiality consultations from FINRA staff, about 80 percent of which were within the last three years. Almost half of the respondents that sought materiality consultations did so at the suggestion of FINRA staff. Roughly only 6 percent of respondents disagree with the statement that the materiality consultation process is effective in helping firms to determine whether a CMA is required. Approximately 70 percent of respondents think that FINRA's rules and published guidance on what constitutes a "material change in business operations" are clear.

Five non-member firm respondents indicated that they helped clients seek materiality consultations. Non-member survey respondents reported that they predominantly were responsible for initiating or suggesting the materiality consultations, as opposed to FINRA staff. Only one of the five respondents does not agree that the materiality consultation process is effective in helping firms to determine whether a CMA is required. In contrast with the member firm respondents, five out of six non-member firm respondents do not think that FINRA's rules and published guidance on what constitutes a "material change in business operations" are clear.

2. Member Firm and Non-Member Firm's Views of the Rules and Processes

- Standards for Admission

Figure 5 shows that for each of the 14 standards for admission, between 76 percent and 91 percent of the member firm respondents believe that the standard is clear and applicable and thus should be maintained. The standard that is considered to be the least relevant by the highest number of respondents (11 percent) is Standard 5 – Business Facilities.

Figure 5: Member Firms' Views Regarding the Standards for Admission Used to Review an Application

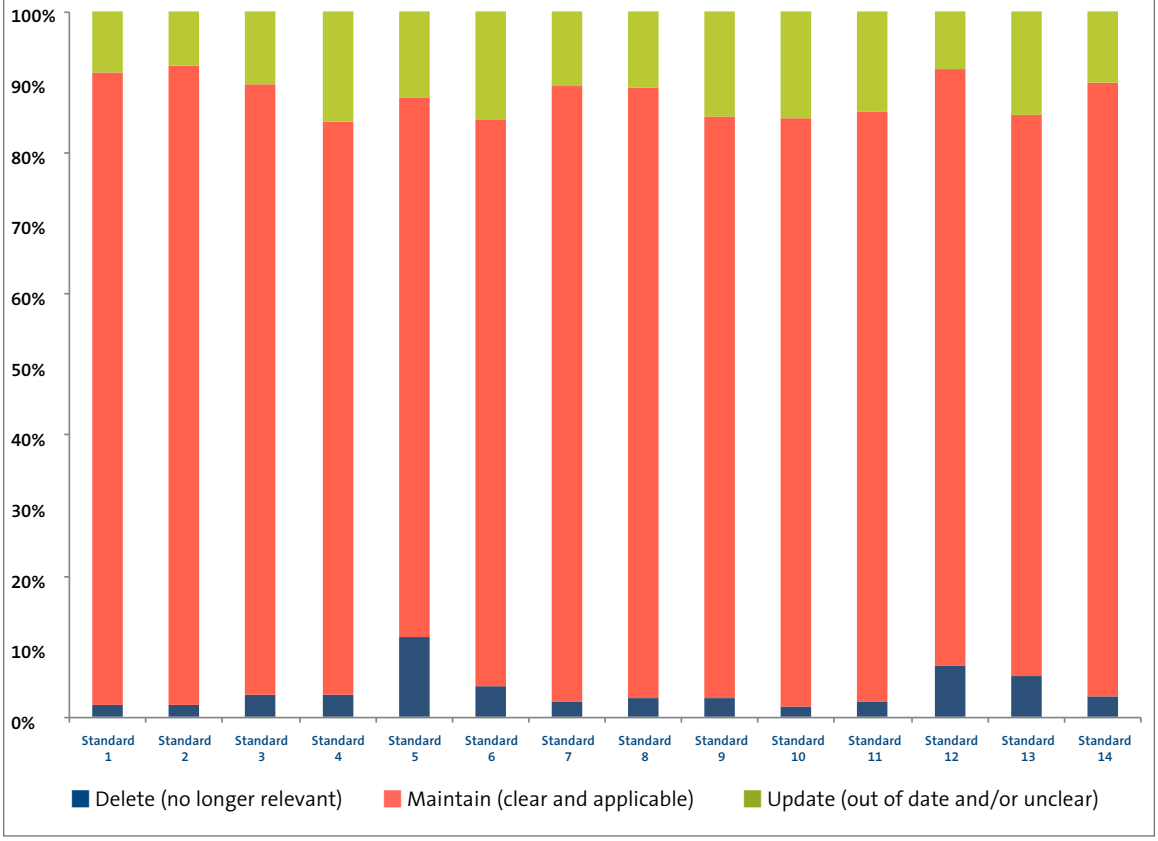
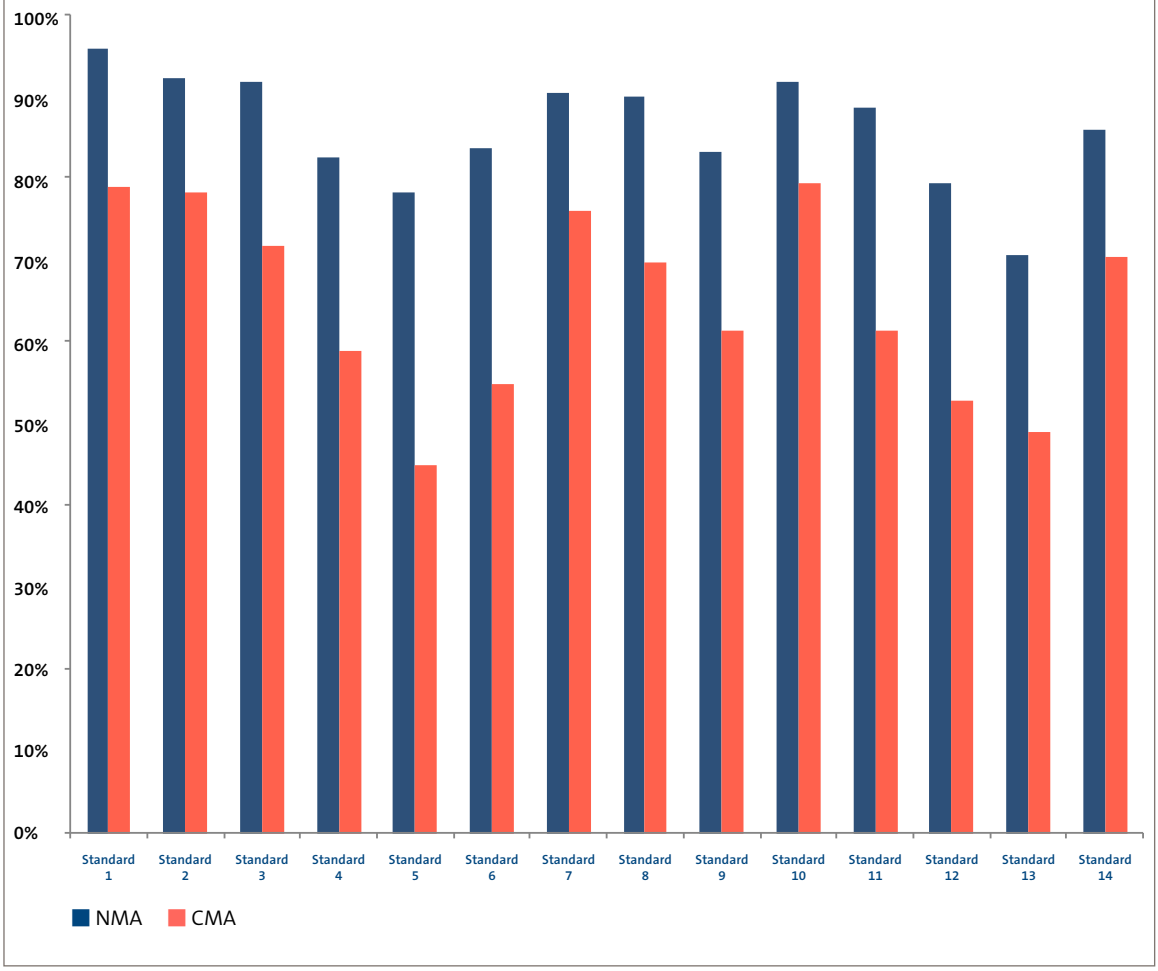


Figure 6 reveals that each standard has more than 70 percent of member firm respondents indicating that they should be required for the review of an NMA. The standard that received the least support is Standard 13 – Other Information Possessed by FINRA. For the review of a CMA, each standard has between 45 percent and 79 percent of respondents supporting its requirement. The standards that received support from less than half of the respondents are Standard 5 – Business Facilities and Standard 13 – Other Information Possessed by FINRA.

Figure 6. Standards for Admission That Should Be Required for NMA and CMA



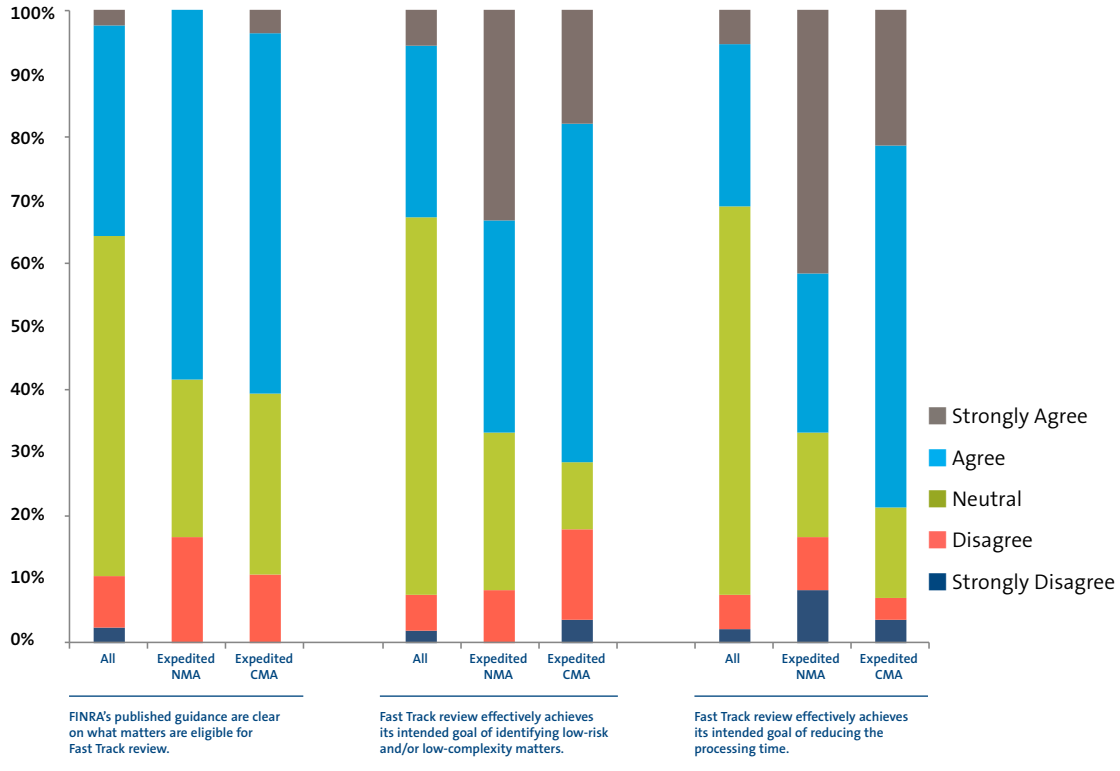
Similar to the member firm respondents, none of the six non-member firm respondents who completed the question on the standards believe that any of the standards should be deleted. Compared to the member firm respondents, non-member firm respondents are more supportive of the use of all standards for the CMA reviews.

- Expedited Handling (Fast Track Review)

As shown in Figure 7, with respect to the Fast Track review program, only 11 percent of member firm respondents disagree that FINRA's published guidance is clear on what matters are eligible for Fast Track review. About 36 percent of the respondents agree with the statement, and the remaining 53 percent of respondents are neutral to the statement. Only 8 percent of the respondents disagree that the Fast Track review effectively achieves its intended goal of identifying low-risk and low-complexity matters. Approximately 33 percent of the respondents agree with the statement and 60 percent of the respondents are neutral to the statement. Similarly, only 8 percent of the respondents disagree that the Fast Track review effectively achieves its intended goal of reducing the processing time. About 31 percent of the respondents agree with the statement and 61 percent of the respondents are neutral to the statement. The respondents that are neutral to the statements have limited exposure to the Fast Track review program. Specifically, only 5 percent of these firms indicated that they had an NMA or CMA that underwent expedited review.

Among the firms that filed an NMA or CMA that underwent expedited review within the last three years, the proportion of respondents that agree with the statements is substantially higher. Specifically, between 58 percent and 67 percent of the firms with NMAs that underwent expedited review agree with the statements that FINRA's published guidance is clear on what matters are eligible for Fast Track review, the Fast Track review effectively achieves its intended goal of identifying low-risk and low-complexity matters, and the Fast Track review effectively achieves its intended goal of reducing the processing time. Similarly, between 61 percent and 79 percent of the firms with CMAs that underwent expedited review agree with the statements. These results indicate that while the Fast Track review program is successful in meeting its objectives, member firms in general may need more information on the program.

Figure 7: Expedited Handling (Fast Track Review)



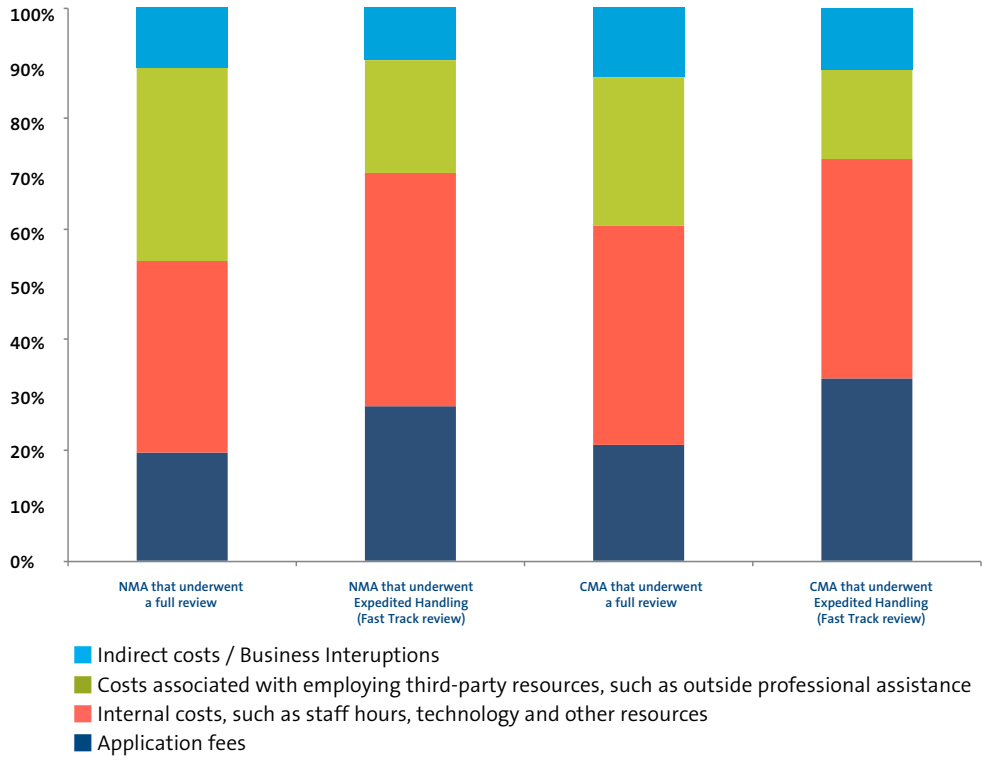
Out of the six non-member respondents who rated their views regarding the Fast Track review, only two disagree that FINRA's published guidance is clear on what matters are eligible for Fast Track review. None disagree that the Fast Track review effectively achieves its intended goal of identifying low-risk and low-complexity matters and reducing the processing time.

3. Economic Impacts

Survey responses from member firms indicate that professional assistance, such as a lawyer or consultant, is commonplace during NMA and CMA processes. Moreover, there appears to be an increase in the use of professional assistance in the last three years.

Figure 8 below shows that for an NMA that underwent a full review, on average, costs associated with employing third-party resources (such as outside professional assistance) are as high on a proportional basis as internal costs (such as staff hours, technology and other resources), with both representing about 35 percent of the total compliance costs. For an NMA that underwent an expedited review or a CMA, the greatest source of cost is associated with internal expenses. For all NMA and CMA filings, the application fees only account for 20-33 percent of the aggregate compliance costs on average.

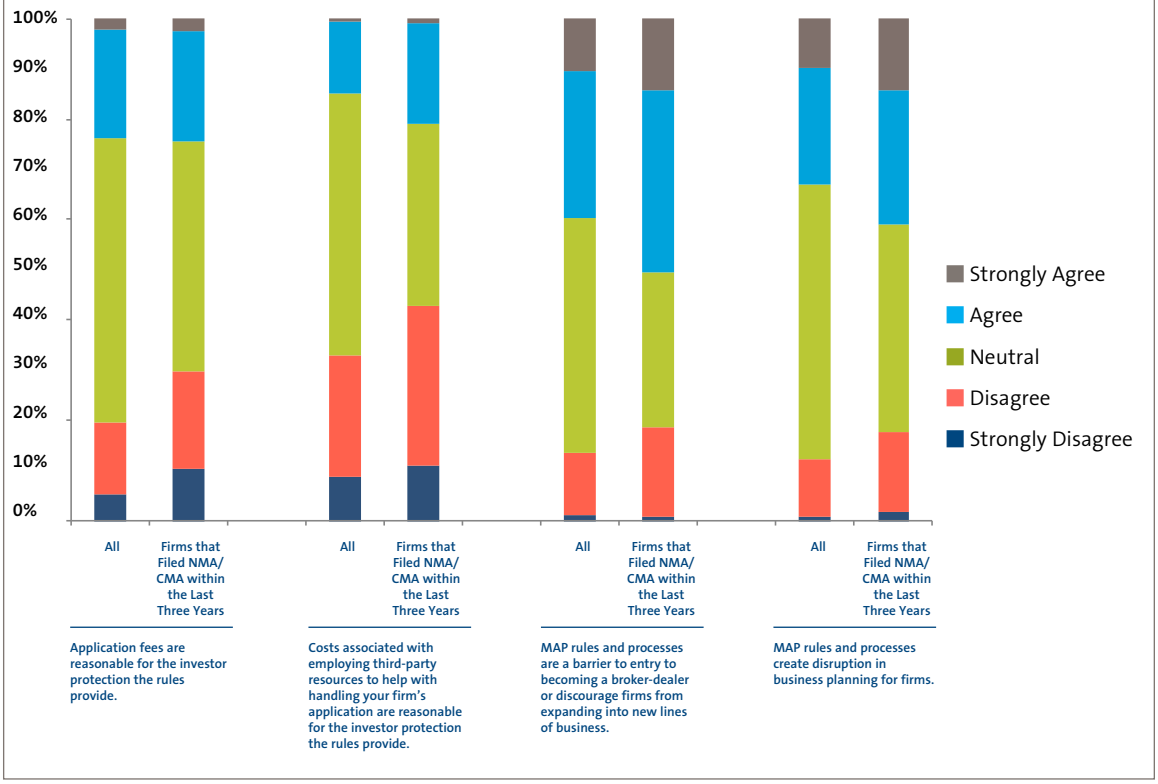
Figure 8. Allocation of Compliance Costs



While 24 percent member firm respondents agree that the application fees are reasonable for the investor protection the rules provide, 56 percent of the respondents are neutral to the statement, and 20 percent of the respondents disagree with the statement. Approximately 33 percent of the respondents do not agree that the costs associated with employing third-party resources to help with NMA and CMA filings are reasonable for the investor protection provided by the rules.

Figure 9 reveals that roughly 40 percent of the respondents agree that MAP rules and processes are a barrier to entry to becoming a broker-dealer or discourage firms from expanding into new lines of business. About 33 percent of the respondents agree that MAP rules and processes create disruption in business planning for firms. Firms with more recent NMA or CMA filings are less likely to be neutral to the statements.

Figure 9. Economic Impacts



Six non-member firm respondents rated their views regarding the economic impacts of the MAP rules and processes. Five are neutral to the statement that the application fees are reasonable for the investor protection the rules provide. Half of respondents disagree that MAP rules and processes are a barrier to entry to becoming a broker-dealer or discourage firms from expanding into new lines of business. Similarly, half of respondents disagree that MAP rules and processes create disruption in business planning for firms.

V. Conclusion

Based on the views expressed, FINRA staff believes that the rules have largely been effective in meeting their intended investor protection objectives. While most responding external stakeholders raised views regarding specific areas for rule guidance and improvements in processing and administration, many also noted that the rules are necessary and have effectively addressed the issues and concerns they were intended to mitigate. The survey results revealed that overall, respondents did not have strong views about the MAP rules and processes. However, those respondents that have had some experience with the MAP rules and processes within the last three years agreed, in general, that the MAP rules and published guidance on the MAP processes have been effective and efficient.

In light of the information obtained through comments and interviews, and the views from FINRA's internal operating departments, the staff believes that the rules and FINRA's administration of them could benefit from some updating and recalibration to better align the investor protection benefits and economic impacts. To that end, external and internal stakeholders identified several areas, described above, where opportunities exist to enhance the efficiency of the rules without reducing investor protection. The advisory committees and the interested trade organization largely validated the areas where opportunities may exist for enhancement.

The staff recommends exploring a combination of guidance, proposed rule modifications, process and administrative changes and technological updates to enhance the effectiveness and efficiency of the rules. The staff recommends initial consideration of the following:

- better aligning the application review process with the relative risk of the applicant and the proposed business line(s), clarifying the types of applications eligible for expedited (*i.e.*, Fast Track) review and expanding the eligible categories;
- streamlining and updating the MAP rules governing the standards for admission and consider defining key terms to clarify the scope and nature of information to be reviewed;
- consolidating and streamlining existing guidance; providing additional guidance on key terms, such as "material change in business operations," "not substantially complete," and the safe harbor for business expansions;
- considering procedural and administrative changes to the MAP rules to increase efficiency, such as aligning certain aspects of the rules governing the process of membership appeals with FINRA's enforcement proceedings;
- updating FINRA's technology and electronic forms that are used to submit and track applications submitted to the MAP Group; and
- improving the efficiency of review processes by, among other things, identifying more effective means to encourage ongoing, regular dialogue between the applicant and the MAP Group.

Endnotes

1. For purposes of the retrospective review, the NASD Rule 1010 Series consists of NASD Rule 1011 (Definitions), NASD IM-1011-1 (Safe Harbor for Business Expansions), NASD Rule 1012 (General Provisions), NASD Rule 1013 (New Member Application and Interview), NASD IM-1013-1 (Membership Waive-In Process for Certain New York Stock Exchange Member Organizations), NASD IM-1013-2 (Membership Waive-In Process for Certain NYSE Alternext US LLC Member Organizations), NASD Rule 1014 (Department Decision), NASD Rule 1015 (Review by National Adjudicatory Council), NASD Rule 1016 (Discretionary Review by FINRA Board), NASD Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations) and NASD Rule 1019 (Application to Commission for Review).

2. An applicant seeking a waiver of the CMA fee would submit its request to the MAP Group as part of the supporting documentation in Standard 1. *See* Section II.B.3 for a description of the CMA fee waiver.

3. There are two registration requirements applicable to all applicants. The first is the two-principal requirement pursuant to NASD Rule 1021(e). The second is the requirement to have at least one person qualified and registered as a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal under NASD Rule 1022. An applicant may apply for a waiver of the two-principal requirement of NASD Rule 1021(e), based on the applicant conducting a very limited scope of business or the applicant having only one person registered with the applicant. An applicant would submit its waiver request in writing, stating the basis on which the applicant believes it has demonstrated that only one person associated with the applicant should be required to be registered as a principal, along with any supporting documentation for the waiver request to the MAP Group as part of the supporting documentation in Standard 2.

4. Form BD data as of January 2016.

5. Since some respondents completed the survey partially, the percentages reported in the discussion of survey results are based on the number of respondents that completed the specific question at issue.

6. *See* FINRA By-Laws, Article I (Definitions).

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