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March 5, 2010

VIA E-MAIL TRANSMISSION

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

Re: Regulatory Notice 10-01

Dear Ms. Asquith:

In Regulatory Notice 10-01 (the "Notice), the Financial Industry Regulatory Authority ("FINRA") requested comments concerning its proposed consolidated FINRA Rules governing its Membership Application Process. This letter provides comments with respect to proposed FINRA Rule 1160 ("Rule 1160"), which relates to Continuing Membership Applications for approval of a change in a member's ownership, control or business operations; proposed Rule 1170 ("Rule 1170"), which requires prior notice to FINRA of certain changes within member firms that do not necessarily require the submission of a CMA; proposed Rule 1112 ("Rule 1112"), relating to the time for certain actions in the Membership Application Process; and proposed Rule 1111 ("Rule 1111"), particularly, the definition of the term "control."

In addition to our comments on the proposed rules, we believe that FINRA should take a procedural step, as described below, with respect to the electronic Form NMA to aid in the efficiency of the process of preparing and filing New Membership Applications ("NMAs"). Finally, we request that FINRA consider the amendment of FINRA Rule 8313(l) with respect to the disclosure of otherwise confidential information in connection with a decision of the National Adjudicatory Council as further described below.

Overview

In brief, we believe that the limitation of the availability of the safe harbor provided in the Supplementary Material to Rule 1160 (Rule 1160.01)(the "Proposed Safe Harbor") is both unwarranted and inconsistent with the underlying basis for the Proposed Safe Harbor. Further,

we believe that the Proposed Safe Harbor, limited as proposed, will have the unintended consequence of inundating the FINRA staff with unnecessary applications for approval of clearly non-material expansions that would not be submitted under the current regulatory structure. Finally, we believe that the Notice fails to adequately notify FINRA members of this change, thereby depriving all but the most observant members of the opportunity to express their views with respect to the proposal.

With respect to Rule 1170, while we recognize the regulatory benefit that notice of some of the enumerated events would provide as an early warning of matters that may require further review by FINRA, we do not believe that the added burden on both member firms and the FINRA staff is warranted with respect to all of the listed items.

Finally, the electronic Form NMA is now available to prospective FINRA applicants only after they have actually filed their Form BD, which prevents them from even beginning to prepare the NMA until that filing has been made. As a purely procedural matter, and one that does not require any rule amendments, we believe that FINRA should decouple the electronic Form NMA from the Form BD so that applicants for FINRA membership would have the ability to work on the Form NMA prior to the actual submission of their Form BD.

Our comments with respect to Rules 1111, 1112 and 8313(l) are discussed below.

Proposed Rule 1160

The Proposed Safe Harbor. Rule 1160 would adopt existing NASD Rule 1017 with various changes as described in the Notice. In general, Rule 1160 sets forth the changes in a member's ownership, control or business operations that require the member to submit a continuing membership application (a "CMA") for approval with FINRA. However, the Proposed Safe Harbor specifies certain changes in a member's business operations (relating to the expansion of Associated Persons involved in sales, offices, or markets made) that are deemed not to be material and therefore will not trigger the requirement to submit a CMA under certain circumstances. But the Proposed Safe Harbor makes a very significant change in language from that which appears in IM-1011-1 that severely limits its availability, and no reference to that change can be found anywhere in the Notice.

As is the case with existing IM-1011-1 (from which the Proposed Safe Harbor is drawn), the Proposed Safe Harbor provides that certain limited expansions of the number of Associated Persons, offices or markets made, in each case based upon the number a member has of each, will not require the submission of a CMA. But the Proposed Safe Harbor is not available under certain circumstances, even if the expansion would otherwise fall within the specified parameters. In pertinent part, proposed Rule 1160.01(a) reads as follows: "This safe harbor is not available to a member that has a membership agreement that contains a specific restriction or

to any member that has disciplinary history." Accordingly, any member that has a membership agreement that has any restriction, whether or not related to any one of the three enumerated matters, would not be able to utilize the Proposed Safe Harbor with respect to any expansion of its business,[1] even if the member has no disqualifying disciplinary history and is not otherwise restricted in the area proposed to be expanded. As a result, such a firm would need to submit a CMA in order to open even one more office or to add just a few Associated Persons.[2]

Section H.4. of the Notice states that the contents of IM-1011-1 were relocated as Supplementary Material to Rule 1160, and points out that "one significant amendment" was made to those relocated provisions. In that regard, the Notice indicates that the Proposed Safe Harbor would not be available to a member that seeks to acquire an office or Associated Persons from a member firm where either the firm or the Associated Persons to be acquired have a disqualifying disciplinary history. Such an exclusion does not appear in IM-1011-1, and a reference to that change in the Notice is therefore appropriate. Since the Notice is silent as to any other changes that were made in the provisions of IM-1011-1, a member reading the Notice without comparing the wording of the Proposed Safe Harbor to IM-1011-1 would conclude from that silence that no other changes were made in that provision. That is not the case.

The existing language of IM-1011-1, and therefore the availability of the existing safe harbor, is in fact much broader than the proposed Supplementary Material. In pertinent part, that language reads as follows: "The safe harbor is not available to a member that has a membership agreement that contains a restriction *as to one or more of the factors listed below. In that case, the agreement takes precedence because FINRA has determined that a particular restriction should apply as to one or more of the factors, and FINRA has issued a decision with a rationale for that restriction."* (emphasis added) First, under this language, the restriction that forecloses reliance on the IM-1011-1 safe harbor must be in one of the three enumerated areas, unlike the Proposed Safe harbor's simple reference to "a specific restriction." And second, under the existing language it is clear that a restriction in a membership agreement controls with respect to the *particular* factor subject to "that restriction," but has no effect on the availability of the IM-

[1] It is not clear why the existence of *any* restriction in a membership agreement would render the Proposed Safe Harbor completely unavailable to a member, but a literal reading of the quoted language would require such a conclusion. Although that conclusion appears illogical, there is nothing in the Notice or the Proposed Safe Harbor that would suggest that FINRA intended to refer only to restrictions in one of the three specifically enumerated areas of expansion.

[2] We recognize that the Proposed Safe Harbor is just a safe harbor, and is not the exclusive determinant of the types of expansions that would, or would not, require the submission of a CMA. If the Proposed Safe Harbor were not available, it may still be that a proposed expansion would be non-material and that no CMA would be required. However, a member would be left to an *ad hoc* determination after discussions with the staff to decide whether a CMA is required in any particular instance, or it could determine on its own that a particular expansion is not material even though it would be outside the safe harbor's parameters. In each case, however, the member would be faced with possible disciplinary proceedings if, after the fact, FINRA disagreed with that determination.

1011-1 safe harbor with respect to an expansion in the other, non-restricted, areas. Foreclosing use of the IM-1011-1 safe harbor only to the subject matter of the restriction and not the other two areas is justified by the fact that while FINRA may have issued a decision with a rationale for "that restriction" when it issued the membership agreement, the decision letter covering the membership agreement would not have expressed any rationale for a restriction in the other two areas since FINRA did not see fit to restrict the member those areas.

Not only would the membership agreement not have expressed any rationale for any restriction other than the factor actually restricted therein, there is no logical reason why a restriction in one of those areas should permeate the other two areas and foreclose use of the IM-1011-1 safe harbor for an expansion therein. For example, if an institutional bond trading firm submitted a CMA in order to become an equity market maker for the first time, FINRA might well approval that activity but impose a restriction in the firm's membership agreement limiting the number of markets the firm could make because the firm's traders or supervisors had limited experience, or perhaps because the firm had only hired a small number of traders or supervisors which would make it difficult for the firm to make additional markets. Under those circumstances, we agree that it may be appropriate for FINRA to require that firm to demonstrate that it had augmented its trading or supervisory capabilities before it should be permitted to make more markets. But that rationale, which clearly applies only to the restriction on market making, would have no bearing on, or relationship to, the issue of whether that firm should be able to open an additional office or hire additional Associated Persons to engage in the institutional bond business in which it may have engaged for many years.

The underlying concept of the existing IM-1011-1 safe harbor, as expressed in NASD NTM 00-73 which announced its adoption, is that certain limited business expansions are simply not material and do not require FINRA review and approval. The fact that a member has a restriction in one area does not transform an otherwise *non-material* expansion, e.g., adding up to 10 Associated Persons in a 12-month period, into a *material* expansion if the member was not previously restricted in the number of Associated Persons it could hire. The three matters are separate and independent of each other, and the fact that circumstances may have existed that resulted in the issuance of a membership agreement that restricted a member's expansion in one of those areas, such as in the institutional bond trading example above, is completely irrelevant to the materiality of the member's expansion in other areas where FINRA had no rationale for issuing a restriction.

The Consequences of the Safe Harbor Change. We believe that the limitation of the availability of the Proposed Safe Harbor in the manner discussed above will have a significant effect on both the FINRA staff and FINRA members. The purpose of the IM-1011-1 safe harbor was to provide the membership with a level of certainty as to the types of business expansions that in all cases would be deemed to be non-material and would not require the submission of a CMA. In that regard, NTM 00-73 pointed out that the creation of the safe harbor was designed

to allow for member growth while permitting the NASD staff to review those expansions that would be most likely to have an effect on a member's financial, compliance or internal control systems. The Proposed Safe Harbor would eliminate that benefit for the staff and for many member firms.

If member firms cannot be certain that an expansion that would otherwise be available under the Proposed Safe Harbor will not be deemed, after the fact, to be material, they will have little alternative but to submit a CMA to avoid the possibility of a disciplinary proceeding for having failed to do so. Preparation and submission of a CMA is time-consuming and expensive, and it diverts management, supervisory and financial resources from the operation and supervision of the member's business. Even if FINRA believes that the approval process would be more streamlined because an expansion within the parameters of the safe harbor would normally be non-material, a member that cannot rely upon the safe harbor cannot know that in advance, and must submit a complete CMA which addresses each of the fourteen (14) standards of NASD Rule 1014 (as relocated in proposed Rule 1130). Moreover, the delay that would result from FINRA's processing of the CMA could well result in a member missing an available business opportunity if it cannot act quickly because it must wait until receipt of FINRA approval. We do not believe it is appropriate to require member firms to submit a CMA for an expansion that FINRA acknowledges is not material for all members who are not specifically restricted from expanding in the particular area involved merely because their membership agreements contain some restriction that has no relationship to the proposed expansion.

In addition to the burden on members, any increase in the number of CMAs that are submitted will have an obvious adverse impact on the workload of the staff and senior management at FINRA. FINRA's already strained resources will be further burdened by the submission of numerous CMAs for very minor expansions, none of which are submitted at present because of the more expansive language of the IM-1011-1 safe harbor.

Lack of Adequate Notice. It is quite clear from the above that the Proposed Safe Harbor is intended by FINRA to limit the availability of the safe harbor from that set forth in existing IM-1011-1. But, as noted above, Paragraph H of the Notice, which explains that existing NASD Rule 1017 would be adopted as FINRA Rule 1160 with various procedural and substantive changes (all of which *are* explained in detail), is completely silent as to this highly significant substantive change in the availability of the safe harbor. It is completely inappropriate for such a change to be made without notice, and without a clear explanation of the reasons for the change, so that FINRA members can have an opportunity to express their views thereon.

Proposed Rule 1170

Rule 1170 appears to be based upon a concern that FINRA may not receive adequate notice of certain changes within member firms that may be material because they do not fall

within the specific requirements of the CMA process as expressed in Rule 1160. While we agree that the occurrence of some of the ten (10) listed events are of sufficient importance that prior notice to FINRA is appropriate, we do not feel that the potential regulatory benefit that may result from notice of other of those events justifies the added burden on member firms or, for that matter, the already over-burdened FINRA staff. The need to provide prior notice in those areas simply creates one more requirement with which a firm may inadvertently fail to comply and thereby expose itself to potential FINRA discipline, when there was little or no benefit to the regulatory process from the notice in the first place.

In particular, we agree that it is desirable for FINRA to be advised when a member firm intends to expand its business in such a manner as to require a capital infusion of 25% or more of its net capital, or that would require new licenses, memberships or other SRO approvals (Item 6), or expands by adding new products or services (Item 7), or when a firm discovers any condition that could lead to material capital, liquidity or operational problems or the impairment of recordkeeping, clearance or control functions (Item 10). We also believe it is appropriate to require a firm to notify FINRA if it expands beyond the parameters of the safe harbor provisions of Rule 1160, because such an expansion is not, by definition, non-material, and FINRA may disagree with the firm's evaluation that no CMA was required notwithstanding the fact that it was outside of the safe harbor (Item 8). Finally, notice of the modification of a business relationship with one of the types of affiliates which must be disclosed in proposed Rule 1121(a)(1)(G)(v) is also appropriate because of the intertwined nature of the enumerated relationships (Item 3). All of these are matters that could potentially raise significant regulatory issues, and it is appropriate for FINRA to receive early warning thereof.

However, we do not feel that the other items of Rule 1170 are necessary either because notice to FINRA is already required, or the regulatory benefit to be gained from the notice does not outweigh the increased administrative burden imposed by the requirement and the risk of disciplinary action for the inadvertent failure to comply therewith. In this regard, all membership agreements now require notification to FINRA of changes in service bureau, clearance activities, and bookkeeping methods or the use of an outside service provider (Item 5), as well as any change in key personnel (Item 4). The requirement to provide notice both under this rule and a membership agreement is duplicative, and could well result in a member failing to provide one of the notices if it believed that only one notice would be required. To the extent that it is necessary to institute this requirement for firms without membership agreements, there should be an exception to the Rule 1170 requirement for those firms that are required to provide such notices pursuant to their membership agreements so as to avoid any duplicate obligations. We also do not feel that notice of acquisitions or divestitures of 10% of assets or lines of business that generate 10% of revenues (Item 1), or acquisitions or divestitures of 10% of shares or ownership interest (Item 2), is warranted. By definition, both under existing NASD Rule 1017 and proposed Rule 1160, events of that type of less than 25% are not deemed to be material so as to require the submission of a CMA, and there would appear to be no reason why events of less

than that magnitude would require FINRA review. Lastly, the listing of a member firm for sale or to solicit possible offers to purchase the firm (Item 9) seems unnecessary. In the event that an agreement is struck that would result in the sale of all or part of a member firm, FINRA will receive appropriate notice thereof through the CMA process. There would appear to be no greater need for pre-notification to FINRA with respect to such a listing than there would for the private negotiation of the possible sale of all or part of a member firm, and no prior notice of that event is proposed to be required. There mere fact that the present owners of a member firm may be considering the sale thereof is not necessarily any indication of potential financial or other problems at the firm, and may only reflect the desire of an owner to retire or liquify all or part of his or her assets. There would appear to be sufficient opportunity for FINRA to review any transaction that may result from that listing when and if an agreement is struck.

Proposed Rule 1112

We do not support FINRA's proposal for either: (i) a reduction in time from 60 days to 30 days to respond to an initial request by FINRA for additional information or documentation before the application is deemed to have lapsed; or (ii) the lapse of the application if an applicant fails to schedule, all of the necessary qualification examinations within 30 days of filing its Form NMA, or if such associated persons have not successfully completed such examinations within 120 days of such filing.

The NMA process and required documentation is substantial and growing more complex, particularly since, under the proposal, a number of the NYSE membership rule requirements are incorporated into the consolidated rules. The vast majority of applicants have no familiarity at all with the maze of the applicable rules and standards. Shortening the time frame for responding to staff cited deficiencies, particularly when the process is becoming more complicated, is not reasonable.

As to the proposed time periods for scheduling and completing examinations, we believe that this new requirement poses significant issues for new applicants. It is already quite difficult for associated persons of broker-dealers to form new firms while they are associated with existing broker-dealers. Indeed, the vast majority of these individuals do not want their current employers to know that they are planning to leave their employ for a multiple of reasons, including the very real possibility that they may be terminated if their employers learn of their proposed venture. As the only means to schedule an examination is by filing a Form U-4 through the WEB CRD System (the "CRD"), their existing employers can learn from accessing the CRD System that such individuals have filed for an examination and that another firm is sponsoring such individuals for such examinations. It becomes particularly dangerous for such individuals at the end of each year because of the annual CRD renewal process when firms are accessing their employees' CRD records.

We think the requirement to schedule the qualification examinations within the 30 day period following the filing of the Form NMA, and requiring their taking by *any* particular time (such as within 120 days of filing the Form NMA), poses a real threat to these individuals who are not yet ready to disclose their plans to their existing broker-dealer employers. Moreover, given the time that it ultimately takes for approval by FINRA after the applicant has satisfied all information and document requests of the staff, the individual principals continue to be exposed to discovery by their employers with no assurance that FINRA will ultimately approve the applicant. While we understand FINRA's desire to ensure that its resources are properly allocated to applicants who are motivated to complete their applications, we believe that the very real exposure to the individual principals resulting from mandated time frames for the scheduling of qualifying examinations, outweighs any potential benefit in moving such applications along.

Separation of Form BD and Form NMA

At the time that FINRA instituted the electronic Form NMA, it coupled that form with the Form BD, so that only the sections of the Form NMA that would be relevant to the lines of business checked on the Form BD would open when an applicant began to complete the Form NMA. While that limitation is not itself a particular problem, the fact that an applicant cannot access the Form NMA *in any respect* prior to the filing of the Form BD is a significant problem because it prevents an applicant from even starting to prepare the Form NMA until it has finalized all aspects of its Form BD and has filed that form. While we appreciate the fact that opening only relevant portions of the Form NMA can make completion of that form more efficient, delaying access to the form until the actual filing of the Form BD eliminates any benefit resulting from the more streamlined form.

It often happens during the organizational process of a prospective new member that, even though it has established all or most of its business plan, it must continue to negotiate with prospective senior personnel or must still work out other aspects of its ownership structure, all of which delays the actual filing of the Form BD. But due to the fact that the Form NMA is linked to the filed Form BD, the member cannot, during that period, begin to prepare the complex responses to the Form NMA, even in draft form. In addition, the applicant will not know exactly what responses are required until it has access to the Form NMA, so that it cannot even prepare the information that will be required to respond to the form. That results in further delays for the submission of the Form NMA and the ultimate approval of the new member's application. In order to avoid this problem, and make the Form NMA procedure more efficient for applicants, we believe that FINRA should make the Form NMA available prior to the filing of the Form BD in a form that would allow an applicant to begin preparing responses. That draft form should be allowed to be saved for further revision as all aspects of the application are finalized.

Proposed Rule 1111; Definition of "Control"

We do not believe that FINRA's proposed change to the definition of "control" under proposed FINRA Rule 1111 should be adopted as proposed. Without explanation or rationale, FINRA seeks to add to the definition of control the fact that a person "is entitled to receive 25 percent or more of the net profits...." We think this change is unfounded. Rather, we believe that the definition of "control" should be substantially the same as the definition in the instructions to Form BD. To apply still another definition of "control" to an already highly regulated analysis of who is in control of a broker-dealer, adds yet another level of complexity into an already complicated regulatory maze.

The various federal and state governmental regulatory authorities have already adopted a uniform standard of what it means to "control" a broker-dealer with the adoption of the Uniform Application for Broker-Dealer Registration (i.e., the "Form BD") after receiving comments from the North American Association of Securities Administrators, the various stock exchanges and myriad self-regulatory organizations, including FINRA, the broker-dealer community, as well as the public at large. And that definition focuses on the ownership of 25% or more of voting securities or the right to receive on dissolution, or the contribution of, 25% or more of capital. There appears to be no basis for expanding that definition to the receipt of some amount of profits, especially when that receipt, under the proposed definition, is not related to any voting power or other ability to affect the management or control of the broker-dealer. We believe that the definition of "control" for the MAP process should be consistent with the Form BD definition of the same term.

FINRA Rule 8313(l)

Although the Regulatory Notice does not solicit any comments on the review process of decisions issued by FINRA concerning the MAP process, we think that FINRA should, while dealing with the NMA/CMA process, amend FINRA Rule 8313(l) for two reasons. First, FINRA Rule 8313(l) specifically cites NASD Rule 1015 which, under the proposal, is to be reassigned as new FINRA Rule 1140. More importantly, however, we think FINRA should at the same time amend FINRA Rule 8313(l) to provide for an *automatic* redaction of any sensitive information, including, without limitation, the name of the broker-dealer and any of its associated persons, that may otherwise be discussed in the written decision to be issued by the National Adjudicatory Council (the "NAC") pertaining to an NMA or CMA. Currently, FINRA Rule 8313(l) leaves the determination of whether such otherwise non-public information about the applicant and its associated persons should be disclosed entirely up to the NAC in its discretion. And that determination does not have to be made by the NAC until the moment before the decision is released.

The MAP process requires the submission of a great amount of information that members would not want publicized through the NAC process including, without limitation, prior disciplinary information about the applicant and/or its associated persons, and additional otherwise non-public information, such as the results of past or pending examination reports, letters of caution, and other confidential information (which would now include information about its affiliates if the proposed MAP rules are adopted). We think applicants should not have to be faced with the Hobson's choice of deciding whether to appeal the decision of the District Staff and face the possibility of having such non-public and often unflattering information placed in the public domain, or accepting the decision of the District Staff with which they may genuinely disagree. We think that is an untenable choice. Instead, a member firm should have the right to appeal the decision on its merits without the fear of having such non-public information placed in the public domain entirely at the discretion of the NAC.

Conclusion

As discussed above, FINRA's rationale for foreclosing access to the Proposed Safe Harbor to member firms that have *any* restriction in their membership agreements is not justified by any rational regulatory purpose. Further, such a limitation will add immeasurably to the business and financial burdens of both member firms and FINRA if the Proposed Safe Harbor is enacted as proposed. Finally, if FINRA does intend to adopt this limitation on the availability of the Proposed Safe Harbor, it is essential that the change in its availability be clearly enunciated in a Notice to Members, along with an explanation of the basis for the limitation, so that the membership can adequately consider and comment on the proposal.

Very truly yours,
Lehman & Eilen, LLP

By: _____
Bob E. Lehman, Partner

By: _____
Lawrence S. Leibowitz, Senior Counsel