BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Continuance in Membership Application of Firm A City A, State A	DECISION Application No. 20100226181 Dated: April 15, 2011

Member Regulation denied the member firm's application to change ownership and control. Held, Member Regulation's denial is affirmed.

Appearances

For Firm A: Attorney A

For Member Regulation: Attorney B

Decision

On April 19, 2010, Firm A submitted a continuance in membership application pursuant to NASD Rule 1017(a)(4).[1] Firm A's application requested FINRA's approval to transfer 100 percent of the firm's ownership and control to several corporate entities. The Department of Member Regulation denied the application because it determined that Firm A's application and all supporting documents were: (1) not consistent with the federal securities laws, the rules and regulations thereunder, and FINRA's rules, as required under NASD Rule 1014(a)(14); and (2) not complete and accurate, as required under NASD Rule 1014(a)(1). Firm A requested our review of Member Regulation's denial. After reviewing the record and the parties' appeal briefs, we affirm Member Regulation's denial.[2]

1 We discuss the rules in effect when Firm A filed the application. NASD Rule 1017(a)(4) requires FINRA members to apply for approval of 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."

2 Neither Firm A nor Member Regulation requested a hearing in this matter. The NAC Subcommittee also did not direct a hearing, but ordered the parties to file appeal briefs.

I. Factual Background

A. Firm A

Firm A became a member of FINRA in 2001. The firm is a limited liability company that has its principal offices in State A. Firm A is a wholly owned subsidiary of Financial Services Company.[3] Financial Services Company entered into a nonbinding letter of intent to sell 100 percent of Firm A to Proposed Parent Company for $50,000.

B. Proposed Parent Company

Proposed Parent Company is not a member of FINRA. Proposed Parent Company is a State B-based holding company for several financial services firms, including an investment advisor and broker-dealer.[4] Proposed Parent Company owns Firm B, which has been a member of FINRA since 1993.

C. Change in Firm A's Operations and Ownership

After Proposed Parent Company acquires Firm A, it intends to change the broker-dealer's name to Proposed Firm.[5] Proposed Parent Company also plans to designate its current broker-dealer subsidiary, Firm B, to manage Proposed Firm's operations. Proposed Firm's executive officers (the former Firm A officers) will be removed and replaced with Firm B's executives, and Proposed Firm's back office operations, business line supervision, registered representatives, and customer accounts will move from Firm A's base of operations in State A to Firm B's main office in State B. At this point, Proposed Firm will be a wholly owned subsidiary of Proposed Parent Company.

Concurrent with these operational changes, Proposed Parent Company intends to initiate a new ownership structure for Proposed Firm. Through the use of a private offering ("Offering"), Proposed Firm will present certain "accounting firms, law firms, property and casualty insurance brokerages and other professional firms" (collectively, the "Professional Firms") with the opportunity to purchase Series A interests in the broker-dealer. The Offering, which Proposed Firm intends to promote only to the Professional Firms, authorizes the sale of a maximum of 35 Series A interests. With a per interest price of $15,000, the Offering could yield a total of $525,000.[6]

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[3] Financial Services Company is a wholly owned subsidiary of Public Accounting Firm.

[4] Proposed Parent Company is a wholly owned subsidiary of Insurance Agency A, which is owned by Insurance Agency B.

[5] "Firm A" refers to the pre-acquisition broker-dealer, and "Proposed Firm" refers to the proposed post-acquisition broker-dealer.

[6] Firm A represents in the application that there are no more than nine or ten Professional Firms interested in purchasing the Series A interests, and that it expects Proposed Firm to raise no more than $150,000 from the Offering. Firm A identified each of the Professional Firms in the application.

1. Purpose of the Proposed Ownership Structure

Firm A's application states that the purpose of the Offering is to capitalize Proposed Firm and to provide Proposed Firm with access to the Professional Firms' "high net worth clientele." The Confidential Offering Memorandum reiterates this point:

> This offering is intended to advance the interests of [Proposed Firm], post acquisition, by providing funding for the operations of [Proposed Firm] and enhance [Proposed Firm's] ability, through its networking agreements with other broker-dealers and registered or licensed entities, to provide investment and insurance products and services to the clients of those [Professional Firms] who become holders of Series A Interests.

The Confidential Offering Memorandum also details the efficiency and novelty of the proposed ownership structure:

> [Proposed Firm] intends . . . to allow the Series A Members to own an interest in a broker-dealer rather than owning an entire broker-dealer. It is anticipated that this structure may be far more cost efficient than wholly owning a broker-dealer, as [Proposed Firm] intends to split the expenses equally among all the Series A Members.
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> [Proposed Firm] also believes that the concept of a broker-dealer owned by multiple Professional Firms is a creative and efficient concept to avoid the need for each Professional Firm to form and register its own broker-dealer or other licensed or registered entities (sic).

Proposed Firm intends to take advantage of these efficiencies by utilizing the Professional Firms' employees to "engage in the retail sales of insurance and investment products . . . [and to] discuss, recommend, and perhaps execute the purchase of a particular insurance or securities (sic) . . . ." Firm A represents in the application that these employees will retain their employment with the Professional Firms, but also will become registered representatives of Firm B (not Proposed Firm).

2. Management and Control of Proposed Firm

The Confidential Offering Memorandum limits the Professional Firms to one Series A interest per purchaser and discloses that the owners of the Series A interests (as a group) will control no more than 49 percent of Proposed Firm, regardless of the number of interests sold in the Offering.[7] Proposed Parent Company, as the only owner of the Series B interest, will retain 51 percent of Proposed Firm.[8]

A Board of Directors will manage Proposed Firm. Because Proposed Parent Company will retain a majority of Proposed Firm's votes, it will control the composition of Proposed Firm's Board of Directors, which will be elected or removed only through a majority vote (51 percent) of all Proposed Firm's interests. Despite this fact, Firm A represents in the application that Proposed Parent Company will fill a majority of the Board of Director positions with its own representatives, then permit representatives of the Professional Firms to occupy the remaining seats. Proposed Parent Company intends to manage Proposed Firm's affairs until the Board of Directors is in place.

3. The Professional Firms' Capital Contributions and Expenses

The Confidential Offering Memorandum states that 100 percent of the proceeds of the Offering will be used to fund Proposed Firm to ensure the firm meets its minimum net capital requirements. Proposed Firm's Operating Agreement provides the details of how the Professional Firms' capital infusion will assist Proposed Firm to meet this obligation. The Operating Agreement states that $5,000 of the $15,000 received from each Professional Firm will be paid to Proposed Parent Company to reduce the company's acquisition, reorganization, and operating expenses, and the remaining $10,000 will be held as a reserve in each Professional Firm's "capital account." Proposed Firm will require each Series A owner to retain $10,000 in capital reserves for the first 12 months of ownership, and $5,000 in capital reserves thereafter.

Each Professional Firm must confirm that it has sufficient reserves in its capital account to pay Proposed Firm's expenses because, on a monthly basis, Proposed Firm accrues its total expenses, divides and allocates the total expenses equally to each Professional Firm, and deducts the prorated amount of the total expenses from each Professional Firm's capital account. As such, each Professional Firm's capital account must have sufficient reserves to meet Proposed Firm's monthly expenses, in addition to the minimum capital reserves. If, at the end of any month, a Professional Firm's capital account reflects a balance less than the required minimum capital reserve, the Professional Firm is subject to a "capital call," and the Professional Firm has 25 days to deposit funds to bring its capital account balance up to the required amount.

4. The Professional Firms' Cash Distributions

Proposed Firm will reduce the amount of the "cash distribution" to which a Professional Firm may be entitled, if any Professional Firm has an unfulfilled capital call. Each Professional Firm, as an owner of Proposed Firm, may receive a quarterly cash distribution from the firm. Cash distributions will be made at the discretion of Proposed Firm's Board of Directors, taking

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7 For example, if there are 10 owners of Series A interests, each owner will have a 4.9 percent interest in Proposed Firm.

8 Firm A represents that this will remain the case, even if Proposed Firm has subsequent offerings.

into account the firm's reserves, regulatory capital requirement, working capital, and business expansion plans. Proposed Parent Company will not receive cash distributions from Proposed Firm.

This cash distribution is measured by "cash flow" attributable to each Professional Firm reduced by each Professional Firm's share of expenses. Proposed Firm's Operating Agreement states that, cash flow is "cash received from ordinary [c]ompany operations or from its networking counterparties (e.g. other broker-dealers such as [Firm B]), including, but not limited to, income received by the [c]ompany under networking agreements, but excluding the sale of any [c]ompany assets or other capital transactions, such as borrowings."

Firm A's application states that, as the Professional Firms' employees execute securities transactions in their capacity as registered representatives of Firm B, they will generate commissions, which will go to Firm B. When Firm B receives these commissions, Firm B will retain a portion of the commissions, pay a portion of the commissions directly to the registered representative, and remit the remainder of the commissions to Proposed Firm.

Because Proposed Firm's expenses will be allocated equally among all Professional Firms, the amount of expenses will be the same for each Professional Firm in any given month, regardless of other factors, such as the amount of Proposed Firm's resources (media, training, etc.) a particular Professional Firm may utilize during the month. Proposed Firm's cash flow, however, will vary from month to month and from Professional Firm to Professional Firm, depending on the amount of securities transactions revenues a particular Professional Firm generates during the month. Proposed Firm's Operating Agreement states that *all* revenues from securities transactions will be tracked and allocated to each Professional Firm's capital account in the manner described below:

> Each [Professional Firm] shall be assigned unique codes (the "Compensation Codes") that correspond to any business associated with, or deriving from, clients received from, or attributable to, that [Professional Firm]. Sub-Compensation Codes, groups of Compensation Codes, or other similar forms of the Compensation Codes shall be used to accurately track and properly allocate the revenue that shall be allocated to each [Professional Firm]. Each [Professional Firm's] [c]apital [a]ccount shall be credited with revenue allocated to [it], based on the Compensation Codes . . . .

D. Member Regulation's Denial of Firm A's Application

Member Regulation denied Firm A's application on October 18, 2010, providing two bases for the denial. First, Member Regulation found that Firm A's application did not meet the standards of NASD Rule 1014(a)(14), which requires that the application and all supporting documents are consistent with the federal securities laws, the rules and regulations thereunder, and FINRA's rules. Specifically, Member Regulation found that Proposed Firm's proposed plan for cash distributions to the Professional Firms "directly related to the business that is derived from clients of that [Professional Firm]" and would be "in direct proportion to the sales identified under [the] [C]ompensation [C]ode [for that Professional Firm]."

Member Regulation concluded that the Professional Firms' proposed cash distributions constitute transaction-based compensation and require each Professional Firm to register as a broker-dealer under Section 15(a)(1) of the Securities Exchange Act of 1934 ("Exchange Act"). Member Regulation found that Proposed Firm's payment of the cash distribution to the unregistered Professional Firms also violates NASD Rule 2420, which prohibits FINRA members from making direct or indirect payments of fees and commissions to non-members.

Finally, Member Regulation determined that Firm A's application failed to meet the standards of NASD Rule 1014(a)(1), which requires that the application and all supporting documents are complete and accurate. Member Regulation's denial states that Firm A failed to "provide a complete application [because Firm A] did not provide adequate documentation to support that the proposed compensation arrangements comply with the requirements of NASD Rule 2420 and Section 15 of the Exchange Act." In its appeal brief, Member Regulation specifies that the "missing" documentation, which renders the application incomplete, is a no-action letter from Commission staff stating that the Professional Firms are not required to register as broker-dealers. Member Regulation argues that Firm A's failure to obtain no-action relief from Commission staff, standing alone, renders the firm's application incomplete.

II. Discussion

Firm A bears the burden of establishing the merits of the application, and, in particular, that the firm meets, and will continue to meet, each of the 14 standards for membership approval contained in NASD Rule 1014(a). *See Homeland Fin. Servs. Group, Inc.*, Application No. A8A050063, 2006 NASD Discip. LEXIS 23, at *32 (NASD NAC Aug. 10, 2006) (citations omitted). We find that Firm A has failed to satisfy its burden. Specifically, we find that Firm A has not proven that the application and all supporting documents are consistent with Exchange Act Section 15(a)(1) and NASD Rule 2420.

A. Exchange Act Section 15(a)(1) and NASD Rule 2420

Exchange Act Section 15(a)(1) governs the registration of brokers and dealers. *See* 15 U.S.C. 78o(a)(1).[9] Absent an exception or exemption, a broker-dealer that "effect[s] any transactions in, or . . . induce[s] or attempt[s] to induce the purchase or sale of, any security" must register with the Commission. *Id.* The Commission has identified a number of factors as relevant to the determination of whether a person is acting in a capacity requiring registration as a broker-dealer pursuant to Exchange Act Section 15(a)(1). *See Joseph Kemprowski*, Exchange Act Rel. No. 35058, 1994 SEC LEXIS 3743, at *5 (Dec. 8, 1994).[10] The Commission considers whether the person: (1) actively solicited investors; (2) advised investors as to the merits of an

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[9] A "broker" is "any person engaged in the business of effecting transactions in securities for the account of others." 15 U.S.C. § 78c(a)(4)(A). A "dealer" is "any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise." 15 U.S.C. § 78c(a)(5)(A).

[10] Our use of "person," similar to the Commission's use of the term, contemplates not only a "natural person," but also a "company, government, or political subdivision, agency, or instrumentality of a government." 15 U.S.C. § 78c(a)(9).

investment; (3) acted with a certain regularity of participation in securities transactions; and (4) received commissions or transaction-based remuneration. *See id.*

Of these factors, Commission staff has emphasized that the receipt of transaction-based compensation is the "hallmark of broker-dealer activity." *Brumberg, Mackey & Wall, P.L.C.*, 2010 SEC No-Act. LEXIS 406, at *2 (May 17, 2010); *see Persons Deemed Not to Be Brokers*, Exchange Act Rel. No. 22172, 1985 SEC LEXIS 1217, at *13 (June 27, 1985) ("[T]he receipt of transaction-based compensation often indicates that [a] person is engaged in the business of effecting transactions in securities.").

Commission staff has concluded that "any person receiving transaction-based compensation in connection with another person's purchase or sale of securities typically must register as a broker-dealer . . . ." *Brumberg*, 2010 SEC No-Act. LEXIS 406, at *2; *1st Global, Inc.*, 2001 SEC No-Act. LEXIS 557, at *5-6 (May 7, 2001) ("Absent an exemption, an entity that receives commissions or other transaction-related compensation in connection with securities-based activities that fall within the definition of 'broker' or 'dealer' . . . generally is required to register as a broker-dealer."). The staff also has explained that proper registration and concomitant regulation are needed to prevent and curtail abusive sales practices. *See Brumberg*, 2010 SEC No-Act. LEXIS 406, at *7.

NASD Rule 2420 compliments this regulatory framework by prohibiting FINRA members from paying any commissions or fees derived from securities transactions to any non-member that may be acting as an unregistered broker-dealer. *See FINRA Regulatory Notice 09-69* (Dec. 2009); *NASD Notice to Members 05-18* (Mar. 2005); *Interpretive Letter to Jay Adams Knight, Esq., Musick, Peeler & Garrett LLP* (Mar. 2001) ("NASD Rule 2420 generally prohibits payment of fees and commissions to non-member broker/dealers. This rule has been interpreted by NASD Regulation to prohibit such payments to entities that operate (or based on the proposed activities, would operate) as unregistered broker/dealers.").

1. Firm A Failed to Establish that the Application Is Consistent with the Federal Securities Laws and FINRA's Rules

Having weighed the evidence and considered the parties' arguments, we are unable to conclude that Firm A has met its burden of showing that the application is consistent with the federal securities laws and FINRA rules. Specifically, we find that Proposed Firm's plan for cash distributions to the Professional Firms raises serious concerns that the distributions may constitute transaction-based compensation, which may require the Professional Firms to register as broker-dealers. We therefore conclude that Firm A has failed to satisfy its burden under NASD Rule 1014(a)(14).

We specifically find that Firm A has failed to satisfy its burden under NASD Rule 1014(a)(14) in two distinct ways. First, Firm A failed to demonstrate that the application was consistent with the federal securities laws because Proposed Firm's payment, and the Professional Firms' receipt, of the cash distributions raises concerns related to transaction-based compensation and registration requirements under Exchange Act Section 15(a)(1). Second, Firm A failed to demonstrate that the application is consistent with FINRA's rules because Proposed

Firm's payment of the cash distributions to the non-member Professional Firms implicates certain prohibitions in NASD Rule 2420.

2. Proposed Firm's Cash Distributions to the Professional Firms Raises Serious Concerns Regarding Compliance with Exchange Act Section 15(a)(1) and NASD Rule 2420

Proposed Firm's tracking and categorizing of revenues from securities transactions by individual Professional Firms, Proposed Firm's use of Compensation Codes "correspond[ing] to any business associated with, or deriving from, clients received from, or attributable to, [individual Professional Firms]," and the allocation of revenues to the Professional Firms based on the Compensation Codes, evidence the nexus between the securities revenues the Professional Firms generate and the cash distributions they receive.

Firm A's "Schematic of [Proposed Firm]" punctuates these connections.[11] The schematic details the revenues, expenses, and cash distributions for the Professional Firms during a hypothetical month of operations, and explains "the methodology of revenues earned . . . and the distribution impact on their general compensation plans." We use the schematic's information related to Professional Firm A for illustrative purposes.

During the month shown, Professional Firm A generates $31,831 in gross dealer concessions from securities transactions. This amount represents 13.42 percent of the Professional Firms' total gross dealer concessions of $237,106 for the month. From the total gross dealer concessions, Firm B deducts its own fees and commissions payments for the registered representatives that executed the securities transactions. After these deductions, Firm B remits the remainder of the gross dealer concessions to Proposed Firm. Proposed Firm receives the remaining gross dealer concessions from Firm B and categorizes it as gross revenue of $215,712. Once Proposed Firm receives the gross revenue, it applies the allocation percentages. Thus, the schematic shows that 13.42 percent of Proposed Firm's gross revenue, or $28,959, is attributable to Professional Firm A. Proposed Firm then deducts its expenses. In the schematic, each Professional Firm pays $1,789 in expenses for the month, which is .83 percent of Proposed Firm's gross revenue. After the deduction of expenses, Professional Firm A receives 12.59 percent of Proposed Firm's gross revenues, or $27,169, as a cash distribution.

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11 The schematic contains the following legend, which assures the Professional Firms that they each will receive credit for all securities transactions attributable to them:

> NOTE: Though [Firm B] is functioning as the broker/dealer and back office, each registered representative of the investors are (sic) assigned a unique code identifying them in order to properly track and account for the transactions and income related to them, which will then be used to offset the operating expenses of [Proposed Firm]. In this way, each investor is assured of receiving their exact specific portion of income generated by them, regardless of any other investor.

As the illustration demonstrates, the cash distributions to the Professional Firms are in direct proportion to the securities transactions the Professional Firms generate. And while the proportion may not be the same from month to month because of the deductions for Firm B's fees, the registered representatives' commissions, and Proposed Firm's expenses, the nexus between revenues from securities transactions and cash distributions is evident and raises concerns that the distributions may constitute transaction-based compensation that would require the Professional Firms to register as broker-dealers. *See Sec. Mut. Life Ins. Co.*, 1993 SEC No-Act. LEXIS 1082 (Oct. 26, 1993) (stating that payments based on "a flat percentage of the net revenues generated by . . . registered representatives" amounted to "compensation directly based on securities transactions").

3. <u>The Responses of Commission Staff to Requests for No-Action Relief in This Area Solidify Our Concerns</u>

a. <u>1st Global, Inc.</u>

We find that Firm A's reliance on the no-action response in *1st Global* is misguided and does not support Proposed Firm's proposed cash distribution plan. *See 1st Global*, 2001 SEC No-Act. LEXIS 557, at *1. Firm A attempts to utilize *1st Global* to persuade us that the "compensation scenarios" to which Commission staff objected when it refused to provide no-action relief are distinguishable from the plan that Proposed Firm intends to employ in this case. We are not persuaded.

1st Global Capital Corp., a registered broker-dealer, engaged certified public accountants as registered representatives ("CPA-representatives") to sell financial instruments to customers. *See id.* at *1.[12] The firm paid the CPA-representatives commissions to compensate them for their securities activities. *See id.* at *1-2. Many of the CPA-representatives, however, were partners of certified public accounting firms ("CPA firms"), which by agreement, required the CPA-representatives to account to their CPA firms for all revenues generated from firm customers. *See id.* at *2. These partnership agreements generally required the aggregation of all partner-generated revenues to pay the CPA firms' overhead, staff salaries, and other expenses, with the remainder of the CPA firms' profits allocated among all the CPA firms' partners according to an established allocation formula. *See id.* Concerns regarding 1st Global Capital Corp.'s commission payments to the CPA-representatives arose because the unregistered CPA firms and partners shared in the CPA-representatives' commissions. *See id.* at *3.

1st Global Capital Corp. therefore asked Commission staff to consider four specific compensation scenarios under which 1st Global Capital Corp. may pay securities commissions to the CPA-representatives. *See id.* at *3. Only the fourth scenario is relevant to the issues

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12 1st Global Capital Corp.'s parent company, 1st Global, Inc., requested the no-action relief at issue. *See 1st Global, Inc.*, 2001 SEC No-Act. LEXIS 557, at *1. Commission staff, however, focused its analysis on the activities of 1st Global Capital Corp., the registered broker-dealer subsidiary, stressing that the "[u]nregistered affiliates of [1st Global Capital Corp.], including 1st Global, Inc., are not eligible to participate in securities activities." *Id.* at *2 n.1.

presented here.[13] The fourth compensation scenario requested no-action relief if "1st Global Capital Corp. . . . pay[s] commissions to another broker-dealer, with which the [CPA-representative] is dually registered, when the CPA firm or its partners own the other broker-dealer." *Id.* at *4.

The staff denied no-action relief for the fourth compensation scenario, explaining that the Exchange Act "not only mandates registration of the individual who directly takes a customer's order for a securities transaction, but also requires registration of any other person who acts as a broker with respect to that order, such as the employer of the registered representative or any other person in a position to direct or influence the registered representative's securities activities." *Id.* at *5-6. The staff concluded that it could not grant 1st Global Capital Corp.'s request for no-action relief for the fourth compensation scenario because there may be circumstances in which the unregistered CPA firm or its partners "may exercise such a degree of control over the activities of the broker-dealer or its registered representatives that they themselves engage in broker-dealer activity." *Id.* at *12.

Because similar concerns resonate here, we find that Firm A has not met its burden in this case. In that regard, we disagree with the argument that the Professional Firms' "mere ownership" of the broker-dealer resolves the issues presented in this matter. In *1st Global*, Commission staff explicitly found that the CPA firm's and partners' ownership of the broker-dealer did not obviate the need to register, even if the CPA firm and partners owned the broker-dealer on a passive basis. *See id.*

We also note that Commission staff has expressed particular concern regarding unregistered persons with a "salesman's stake" in securities transactions. *See id.* at *5. The staff has explained that, among other things, "registration helps to ensure that persons with a 'salesman's stake' in a securities transaction operate in a manner consistent with customer protection standards governing broker-dealers and their associated persons, such as sales practice rules." *Id.* Those same concerns exist here. The Professional Firms will profit in an amount that is proportional to the level of securities-related activity in which their customers engage. Because the Professional Firms will have a salesman's stake in the securities transactions that the dually registered representatives execute, they may be required to register as broker-dealers.

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[13] The three other compensation scenarios examined whether 1st Global Capital Corp. could pay securities commissions to the CPA-representatives if they: (1) did not have partnership agreements mandating that the CPA-representatives account to the CPA firm for commissions earned; (2) did not have a partnership agreement mandating that the CPA-representatives account to the CPA firm for commissions earned, but the CPA-representatives "voluntarily" turn the commissions over to the CPA firm; and (3) were subject to agreements, formal or otherwise, mandating that the CPA-representatives account to the CPA firm for the commissions earned. *See id.* at *3-4. Commission staff granted 1st Global Capital Corp.'s request for no-action relief *only* on the first proposed compensation scenario, stressing that the no-action position was "conditioned on the fact that no CPA [firm partner], other than one who is a registered representative who is not subject to an agreement of the sort described above, will be eligible to receive commissions, even indirectly, through partnership distributions." *Id.* at *7 (citing *Freytag, LaForce, Teofan and Falik*, 1988 SEC No-Act. LEXIS 1346, at *10 (Jan. 4, 1988)).

b. Professional Firm A

We also consider it persuasive that Commission staff previously has opined on a similar arrangement between Firm B and Professional Firm A, both of whom are involved in this matter. *See Professional Firm A* (citation omitted). In November 2001, Professional Firm A requested no-action relief to act as an intermediary and process securities commissions on behalf of employees who were dually registered with Firm B ("PF-representatives"). *See id.* at *1, 8.

Professional Firm A proposed that when a PF-representative received a commission check from Firm B, the PF-representative would deposit the check into his or her own bank account, and write a separate check to Professional Firm A. *See id.* at *2. Professional Firm A then would combine the securities commissions with other revenues that the PF-representative had generated, deduct overhead, payroll taxes, and fringe benefit costs, and remit the balance of the commissions, i.e., the "net commissions," to the PF-representative. *See id.* Professional Firm A represented that net commissions would be paid only to the PF-representative who produced the business, would not be reallocated to any person other than the one who generated the commissions, and would not be reallocated to someone who is not a registered representative. *See id.*

In response to Professional Firm A's request for no-action relief, Commission staff explained that Professional Firm A had provided Firm B with "de facto marketing services," and noted that Professional Firm A did not appear to "occupy a wholly indifferent and ministerial position with regard to the [PF-representatives'] securities activities." *Id.* at *6. Having concluded that Professional Firm A viewed the PF-representatives' securities transactions as "linked to [its] own business operations," the staff denied Professional Firm A's request for no-action relief. *Id.*

The staff's response to Professional Firm A's request examined the proposal we are confronted with here, albeit from the Professional Firms' side of the transaction. And, while the staff did not explicitly examine the plan from Proposed Firm's or a broker-dealer's perspective, we nevertheless find the analysis relevant.

Indeed, the current matter presents stronger reasons for requiring registration as a broker-dealer. In 2001, Professional Firm A proposed only to serve as an intermediary and process the PF-representatives' securities commissions. *See id.* at *1. Professional Firm A explicitly stated that it intended to earn no profit from the securities transactions. *See id.* at *2. In the matter before us, however, Professional Firm A will have a salesman's stake in the securities transactions, directly profiting from the securities transactions that the PF-representatives execute. *See id.* at *4.

We are also troubled because Professional Firm A, as a company, will receive the cash distributions directly from Firm B, and will do so without any safeguards to ensure that the cash distributions will not be shared with other unregistered partners, owners, or personnel at Professional Firm A. *See id.* at *2. To the contrary, Firm A's application guarantees that these unregistered persons will receive revenues from securities transactions. The Commission staff's rejection of Professional Firm A's request for no-action relief in 2001 reinforces our concerns with Proposed Firm's plan for cash distributions to the Professional Firms.

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The responses of Commission staff to 1st Global Capital Corp.'s and Professional Firm A's requests for no-action relief do not assuage, but solidify, our concerns that Proposed Firm's proposed cash distributions may constitute transaction-based compensation, require the Professional Firms to register as broker-dealers under Exchange Act Section 15(a)(1), and cause Proposed Firm to violate NASD Rule 2420. Because Firm A has not resolved these concerns, and adequately demonstrated that the application and proposed change in ownership are consistent with the federal securities laws and FINRA's rules, as required under NASD Rule 1014(a)(14), we affirm Member Regulation's denial.[14]

III. Conclusion

After a complete and independent review of the record and the parties' appeal briefs, we have concluded that Firm A has failed to establish that the application and all supporting documents were consistent with the federal securities laws and FINRA's rules, as required under NASD Rule 1014(a)(14). Firm A's application and all supporting documents, however, were complete, as required under NASD Rule 1014(a)(1). We affirm Member Regulation's denial of Firm A's application. We have considered, and reject without discussion, all other arguments of the parties.

On behalf of the National Adjudicatory Council,

Marcia E. Asquith

Marcia E. Asquith,
Senior Vice President and Corporate Secretary

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[14] In September 2010, nearly five months after Firm A submitted the application, Member Regulation requested that Firm A obtain no-action relief from Commission staff to proceed with the proposed acquisition. Although there is no evidence in the record that Firm A requested or obtained the relief, we find that the absence of the no-action letter in this instance does not render the application incomplete under NASD Rule 1014(a)(1).