BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the New Member Application of Applicant Firm	DECISION Application No. 20090196759 Dated: December [ ], 2010

FINRA's Department of Member Regulation denied a firm's application for FINRA membership. Held, Member Regulation's denial is affirmed.

Appearances

For Applicant Firm: President of Applicant Firm ("Person 1")

For the Department of Member Regulation: Attorney 1, Department of Member Regulation

Decision

Pursuant to NASD Rule 1015(a), the Applicant Firm ("Applicant Firm" or "the Firm"), appeals from a May [ ], 2010 decision of the Department of Member Regulation ("Member Regulation") denying the Applicant Firm's application for FINRA membership. After conducting a hearing and reviewing the record, we affirm Member Regulation's decision to deny the application for FINRA membership.

I. Background and Procedural History

A. Applicant Firm

The Applicant Firm was organized on September [ ], 2008, as a domestic for-profit corporation under State 1 law. As of May [ ], 2010, Person 1 was the primary owner of Applicant Firm, and "Person 2" had an ownership interest of less than five percent. The Applicant Firm's principal office is in City 1, State 1.

B. Procedural History

On September [ ], 2009, the Applicant Firm filed an application for FINRA membership by filing a New Membership Application Form ("Form NMA"), which in turn attached, among other things, a business plan and an organizational chart. On March [ ], 2010, the Firm requested a 60-day extension of the 180-day deadline in NASD Rule 1014(c) for the issuance of the decision. On March [ ], 2010, Member Regulation granted that request and extended the decision deadline to May [ ], 2010. The Applicant Firm subsequently requested a further extension of the decision deadline until May [ ], 2010, which Member Regulation also granted.

Throughout the processing of the application, Member Regulation made numerous requests for additional information, and the Applicant Firm provided responses.[1] Member Regulation also conducted a membership interview with the Applicant Firm on February [ ], 2010.

On May [ ], 2010, Member Regulation denied the Applicant Firm's application for FINRA membership. Its decision was based upon two grounds. First, Member Regulation determined that because "[t]he Applicant has demonstrated a pattern of submitting incomplete information," it has not met the standard in NASD Rule 1014(a)(1), which requires that the application and all supporting materials be "complete and accurate." Second, Member Regulation found that "[f]or multiple reasons, the Applicant has not demonstrated it meets the Standards in [NASD] Rule 1014(a)(10) which require an adequate supervisory system."

On June [ ], 2010, the Applicant Firm appealed Member Regulation's decision. The Applicant Firm subsequently requested a hearing. On July [ ], 2010, Member Regulation transmitted a corrected set of all documents that were considered in connection with its decision ("the corrected record") and an index, pursuant to NASD Rule 1015(b).[2] On August [ ], 2010, a Subcommittee of the NAC presided over an evidentiary hearing at which the parties presented opening and closing arguments, witness testimony, and documentary evidence.[3] The

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[1] Member Regulation made requests for information on October [ ], 2009; January [ ], 2010; March [ ], 2010; and May [ ], 2010. The Applicant Firm responded to these requests on December [ ], 2009; February [ ], 2010; April [ ], 2010; and May [ ], 2010. The Applicant Firm filed amended Forms NMA on December [ ], 2009; January [ ], 2010; February [ ], 2010; February [18], 2010; February [ ], 2010; April [ ], 2010; and May [ ], 2010.

[2] Member Regulation filed an initial record that the Office of General Counsel returned for further processing. After Member Regulation filed the corrected record, the Applicant Firm filed a July [ ], 2010 motion to direct Member Regulation to produce: (1) a "MAP Task Analysis" form, which was referenced in another document contained in the corrected record; and (2) a list of all documents that Member Regulation withheld. Member Regulation opposed the motion arguing, among other things, that it had fully complied with its obligations under Rule 1015(b), and that the MAP Task Analysis Form was an internal staff database that contained privileged and confidential information concerning its processing of the membership application. After considering the parties' arguments and reviewing the MAP Task Analysis form *in camera*, the Subcommittee denied the Applicant Firm's motion. We have considered the Subcommittee's disposition of this motion and adopt it as our own.

[3] The Applicant Firm presented two witnesses: (1) Witness 1, a principal examiner with Member Regulation's Centralized New Member Application Group; and (2) Person 1. The Applicant Firm also introduced four exhibits that the Subcommittee accepted into evidence. Member Regulation presented two witnesses: (1) Witness 1; and (2) Witness 2, Associate District Director, Member Regulation. Member Regulation also introduced 28 exhibits that the

[Footnote continued on next page]

Subcommittee presented its recommended decision to the NAC in accordance with the deadline agreed to by the parties.

II. Facts

A. During the Application Review Process, the Applicant Firm Repeatedly Amended Its Proposed System of Supervision

Throughout the application process, the Applicant Firm repeatedly amended its proposed organizational structure, personnel, and system of supervision. In denying the new membership application on the grounds that the Applicant Firm's application was not complete, as required by NASD Rule 1014(a)(1), Member Regulation found that the Applicant Firm "has presented three different supervisory structures between September 2009 and May 2010" and that such "repeated changes . . . , particularly those occurring late in the application process, demonstrate that the [Applicant Firm] has still not conclusively decided who the principals will be." The relevant facts are as follows.

1. September 2009 Application

The Applicant Firm's September [ ], 2009 application contained its initial proposed system of supervision and initial organizational structure. The Applicant Firm represented that its principal office would be Person 1's personal residence in City 1, State 1, which would be an Office of Supervisory Jurisdiction ("OSJ"). In its business plan, the Applicant Firm explained that it sought to conduct a number of different businesses, including "offer[ing] a broker-dealer platform to individuals that are engaged in mergers and acquisitions" ("M&A" or "mergers and acquisitions"); "assist[ing] in the planning and development of financing options (equity and debt underwritings)"; "enter[ing] into Selling Agreements as either a Managing Director or as a Selling Group Member"; and "providing a platform for the public and private placement of securities and the sale of tax shelters and limited partnerships in such areas as oil & gas, wind energy, equipment leasing and real estate."[4] The Applicant Firm also represented in its Form

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[cont'd]

Subcommittee accepted into evidence. We adopt all of the Subcommittee's evidentiary rulings as our own.

[4] Likewise, the Applicant Firm's initial Form NMA indicated that it sought to engage in the following business lines: (1) underwriter or selling group participant (corporate securities other than mutual funds); (2) broker or dealer selling oil and gas interests; (3) broker or dealer selling tax shelters or limited partnerships in primary distributions; (4) private placement of securities; and (5) mergers and acquisitions.

NMA that it intended to service retail (non-high net worth) customers, high-net worth customers, and institutional (excluding high-net worth) customers.

The Applicant Firm also conveyed who would comprise the Applicant Firm's initial management. Under its initial proposal: (1) Person 1 would be the Applicant Firm's president and designated principal; (2) Person 2 would be the financial and operations principal ("FINOP"; and (3) Person 3 would be the chief compliance officer. The Applicant Firm represented that Person 1, Person 2, and Person 3 all would be based out of the State 1 office, would work part-time for the Applicant Firm, and would also be employed by other firms or entities. The Applicant Firm also anticipated hiring "a [g]eneral [s]ecurities [p]rincipal to run the day-to-day operations of the firm once a relationship has been established with [a mergers and acquisitions] private placement firm" and hiring, within the first year of operations, "10 or less registered representatives involved in sales."

The Applicant Firm represented that "[n]o other offices, registered or unregistered, [besides the main office] are anticipated at this time." The organizational chart showed, however, that any OSJs and registered branch offices identified in the future would report directly to Person 3.

2. February 2010 Amendments

On February [ ] 2010, the Applicant Firm made its first change to the proposed supervisory system and structure. The Applicant Firm stated that it was scaling back its proposed businesses to include just mergers and acquisitions and the private placement of securities.[5] In a letter to Member Regulation, the Applicant Firm represented that it would "have no retail customers"[6] and that its mergers and acquisitions work may involve private placements of debt or equity securities only to "accredited/institutional investors."[7] The Applicant Firm also stated that it expected Person 4 would join the Applicant Firm in a "[s]upervision/[n]on [s]ales" capacity.[8] The Applicant Firm reiterated that it would have no more than 10 associated persons

[5] Although the Applicant Firm reflected this change of business lines in one part of its Form NMA, another part continued to state that the Firm would be "acting as a broker/dealer platform for oil and gas issuers."

[6] The Applicant Firm failed to make a corresponding change regarding its targeted customer base in its Form NMA.

[7] At the hearing, Person 1 clarified that this meant accredited *or* institutional investors, and that the accredited investors would include business owners.

[8] The Firm did not add information about Person 4 to either the Form NMA or to the Firm's business plan.

involved in sales but conveyed that it anticipated opening "no more than 3 offices not including the main office."[9] The Applicant Firm also clarified that "[n]o sales activity will be conducted from the main office."

3. April 2010 Amendments

On April [ ], 2010, the Applicant Firm made substantial changes to its proposed supervisory system and organizational structure. In a letter to Member Regulation, the Applicant Firm explained that "while no sales will originate from the [home office], all sales will be routed through the home office for approval by Person 1" and that "the principle [sic] office . . . will be the location where all business is reviewed and approved." Under the new supervisory plan, Person 1 would be "the primary supervisor and [c]hief [c]ompliance [o]fficer," and his responsibilities would include "directly supervising the registered representatives," "running the day-to-day operations of the firm," and "supervising the OSJ." As for Person 3, the Applicant Firm explained that "due to [Person 3's] taking on additional [outside] commitments," it had "revised [Person 3's role] to that of a secondary principal and compliance consultant who will provide compliance services on an as needed basis."[10] The Applicant Firm also stated that its organizational chart now reflected that Person 3 would no longer be responsible for supervising the OSJ or any registered branch offices.

In another change, the Applicant Firm explained that Person 5 would be joining the Applicant Firm as an "[a]lternate" or "secondary [p]rincipal." Person 5 would "assist in complying with the review of [mergers and acquisitions] transactions" on an "as needed basis," and, together with Person 3, would "assist Person 1 in fulfilling his obligations as the designated principal."

The Applicant Firm also implied that Person 4 was no longer part of the planned supervisory system, stating that she was "currently exploring other options." The Applicant Firm also represented that, should its business "grow[ ] faster than anticipated and additional supervision is needed, [it] will hire an additional [g]eneral [s]ecurities [p]rincipal and segregate those functions currently being performed by Person 1," but that it did not anticipate the need to do so within the first two years of the Firm's operations.

The Applicant Firm also stated that, within the previous two months, it had identified "one potential office" and Person 6 as "one M&A Intermediary to potentially join the firm."

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[9] Notwithstanding this change, the Firm's business plan continued to state that the Firm did not anticipate opening any additional offices besides the main office.

[10] Despite this amendment, the Firm continued to refer to Person 3 in one section of Form NMA as the proposed chief compliance officer.

4. May 2010 Amendments

The Applicant Firm's third round of changes to the supervisory system and organizational structure came on May [ ], 2010. In a letter to Member Regulation, the Applicant Firm added additional details about Person 6. The Applicant Firm anticipated that Person 6 would perform his activities on behalf of the Applicant Firm out of his office with his current company, Firm 1, located in City 2, State 2.[11] The Applicant Firm also explained that Person 6 "contracts the services of two junior investment bankers," Person 7 and Person 8, who "serve under [Person 6's] direction and supervision" and who had been advised that they would need to register with the Applicant Firm should Person 6 be approved as a representative of the Applicant Firm.

In addition, the Applicant Firm indicated for the first time that Person 6 was "in negotiations with" Person 9 to have her join as a "[b]ranch [o]ffice [p]rincipal" of the City 2 office.[12] The Applicant Firm stated that, "if approved, Person 9 would be able to provide regular onsite meetings with Person 6 and provide ongoing full-time oversight of Person 6 and his staff."[13]

B. The Applicant Firm's Proposed System of Supervision

As of the Applicant Firm's last round of amendments, the Applicant Firm's proposed system of supervision contains the following relevant elements.

1. Offices

As explained above, the Applicant Firm proposes that its principal office in City 1, State 1, would be an OSJ. No sales activity would be conducted from the main office. The Applicant Firm also anticipates opening "no more than 3 offices not including the main office." The Applicant Firm states that "[b]ecause of the nature of the M&A business, we expect each of the offices to have very few transactions." The Applicant Firm emphasizes that its planned rate of

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[11] The Applicant Firm did not make any changes to Form NMA or its business plan to account for either the State 2 office or Person 6.

[12] The Applicant Firm did not make any changes to Form NMA or the Firm's business plan to account for the possible addition of Person 9.

[13] As noted above, throughout the application process, the Applicant Firm sometimes communicated amendments through its correspondence with Member Regulation without making corresponding or consistent changes to its Form NMA, its business plan, or its written supervisory procedures. Person 1 acknowledged such discrepancies, but testified that his intent was that the changes communicated in his correspondence always governed.

expansion is consistent with the "safe harbors" outlined in IM-1011-1.[14] At present, the Applicant Firm has identified the office in City 2, State 2, where Person 6 would perform his activities on behalf of the Applicant Firm, as one possible office. The Applicant Firm also has identified Person 2's personal residence in City 3, State 1, as a non-branch office.

2. Principals

The Applicant Firm proposes that Person 1, Person 3, Person 5, and Person 2 would serve as general securities principals. None of those proposed principals would be "producing" supervisors. Each person would work in a part-time capacity.

Person 1 would be the Applicant Firm's president, primary supervisor, chief compliance officer, sole director, executive representative, and anti-money laundering "officer." Person 1 would work from the Applicant Firm's home office in City 1, State 1. He would be directly supervising the registered representatives, running the day-to-day operations of the firm, and supervising the OSJ.

Person 1 also works as a compliance consultant for his own consulting firm, Firm 2. His firm is "a full range provider of consulting services to the broker/dealer industry," including "New Member Application[s], [anti-money laundering] and Books and Records Audits, [FINRA Rule] 3012 Testing, and investigation, analysis and resolution of regulatory issues." Person 1 continues to devote approximately 40-60 hours per month to his consulting firm, and plans to devote approximately 20-30 hours per month to the Applicant Firm.[15]

Person 3 would be a general securities principal, and his title would be "[s]econdary [p]rincipal." The Applicant Firm's written supervisory procedures indicate that Person 3 would be based out of the City 1, State 1 office. The Applicant Firm represents that Person 3 "has over twenty years of financial services experience and currently serves as an independent securities compliance consultant." Person 3 intends to be registered with the Applicant Firm and several

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[14] IM-1011-1 sets forth the increases in registered or unregistered offices that, for eligible firms, are presumed not to be a "material change in business operations" that requires an application under NASD Rule 1017.

[15] The Applicant Firm explained that Person 1 "has many years of experience working both with regulators and with private clients performing compliance functions." In addition to his consulting experience, Person 1 was a securities examiner with the State 1 Securities Board from 1989 to 1995 and an examiner with FINRA's (then NASD) District [ ] Office from February 1996 to March 2004. Notably, among his duties at FINRA, Person 1 "executed the NASD's Membership Application Program in District [ ] to determine whether applicants and/or members met the standards for admission to, or continuance in, membership set forth in the rules."

other registered entities.[16] In those other registered capacities, Person 3 performs branch audits and other compliance functions. Person 3 also plans to continue consulting work with his own consulting firm, Firm 3, and possibly other consulting firms.[17] The Applicant Firm represents that Person 3 would devote approximately 10 hours per month to the Applicant Firm, 35-40 hours per week to his other broker-dealer employers, and 5-10 hours per week to his consulting work.

Person 5 would be a general securities principal, and his title would be "[a]lternate [p]rincipal" or "[s]econdary principal." The Applicant Firm's written supervisory procedures indicate that Person 5 would be based out of the City 1, State 1 office. The Applicant Firm represents that Person 5 has "over 10 years [experience] in the securities industry." Person 5 is an owner, founder, and the current vice president of finance for a non-registered start-up energy company in City 3, State 1, which provides consulting services to municipalities and private fleet owners. Person 5 plans to continue devoting approximately 40 hours per month to his position with his start-up energy company. The Applicant Firm made no representations, however, concerning how much time Person 5 plans to devote to the Applicant Firm.

Person 2 is the Applicant Firm's proposed introducing broker-dealer FINOP. Person 2 would perform his Applicant Firm responsibilities out of his personal residence in City 3, State 1, which the Applicant Firm identifies as a "non branch office." Person 2 is registered as a FINOP with three other registered entities: Firm 7, Firm 8, and Firm 9. The Applicant Firm represents that Person 2 would devote approximately 20 hours per month to the Applicant Firm and 60 hours per month to his other positions.

In addition to these principals, the Applicant Firm also noted that it is in "negotiations" to have Person 9 join as a branch office principal of the State 2 office. The Applicant Firm represented that, if hired, Person 9 would "provide ongoing full-time oversight of Person 6." The Applicant Firm indicates that Person 9 has "maintained an ongoing professional relationship with Person 6 since 2003" and "has served side by side with [him]" as vice president of a

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[16] As of the hearing, Person 3 intended to associate with, or continue associating with, at least three other broker-dealers. Person 3 is the proposed chief compliance officer of Firm 4; the FINOP of Firm 5; and the FINOP of Firm 6. In its decision, Member Regulation noted that the firms with which Person 3 associates are "geographically widespread." Member Regulation did not introduce into evidence any documentary records supporting that conclusion. We take judicial notice of such firms' CRD records, however, that show that such broker-dealers are geographically widespread.

[17] Throughout the application, the Applicant Firm identified four consulting firms that Person 3 has associated with, including his own consulting firm, Person 1's consulting firm, and two other firms.

networking organization for entrepreneurs. The Applicant Firm has not submitted a Form U4 on behalf of Person 9, and she is not reflected in the Applicant Firm's business plan, its Form NMA, or its written supervisory procedures.

3. Representatives

As explained above, the Applicant Firm has proposed that Person 6 may join the Applicant Firm as an "M&A [i]ntermediary." The Applicant Firm represents that Person 6 has "over 25 years of executive and management operating experience in developing a wide range of leading edge electronic products and technologies." However, Person 6 is new to the securities industry. Person 6 passed the corporate securities limited representative qualification examination on April [ ], 2010. He has not taken any other qualifications examinations, and he has not previously been registered with a broker-dealer.

Person 6 has positions with a number of other companies. He is: (1) managing director of Firm 1, where he heads the Electronics and Semiconductor Group, a "specialty investment banking practice focused almost exclusively on middle market electronics technology companies"; (2) president of Firm 10, a "business consulting firm providing non-investment related M&A Staging Services to improve the marketability of an M&A prospect"; (3) president of Firm 11, which "receives and manages all [of Person 6's] consulting income through M&A activities and all other business activities"; and (4) president of Firm 12, a "non-investment related Technology Company" that is "not a going concern."

The Applicant Firm represents that the majority of Person 6's business projects are "domestic," but "a number have [involved] companies based in Europe and Asia" and "he is currently opening strategic activities in India." With respect to his foreign business activities, Person 6 "provides business advisory and M&A consulting services to non-US entities and natural persons residing in several countries." The Applicant Firm wrote that "[i]n all cases such [foreign] engagements will be disclosed to the Applicant Firm and where applicable under its supervision as documented in the [written supervisory procedures]."

4. Off-Site Supervision of the State 2 Office

The Applicant Firm explained how it planned to monitor Person 6 from the City 1, State 1 office. The Applicant Firm plans to monitor Person 6's (and his support personnel's) electronic communications using an e-mail monitoring system, review all documents related to any possible securities transaction using an online document repository, and conduct "spot checks" during visits to the State 2 office. The Applicant Firm has no plan for monitoring Person 6's in-person or telephone securities solicitation activities.

III. Discussion

NASD Rule 1014(a) delineates numerous standards that an applicant must meet before Member Regulation may approve a request for membership admission. In general, the standards in NASD Rule 1014(a) are intended to ensure that members are capable of satisfying all relevant regulatory requirements for the protection of the investing public, the securities markets, the firm, and other member firms. *Membership Continuance Application of Member Firm*, Application No. 20060058633, 2007 FINRA Discip. LEXIS 31, at *44-45 (FINRA NAC July 2007). The applicant in a new membership application bears the burden of demonstrating that it meets each of the rule's fourteen standards. *New Membership Application of Firm A*, Application No. 20090182345, 2010 FINRA Discip. LEXIS 24, at *22 (FINRA NAC Sept. 28, 2010); *see* NASD Rule 1014(a) ("[T]he Department shall determine whether the Applicant meets each of the [rule's] standards."). Member Regulation found that the Applicant Firm failed to meet two of those standards, NASD Rule 1014(a)(1) and (a)(10). As explained below, we affirm those findings and deny the Firm's membership application.

A. NASD Rule 1014(a)(1)

Member Regulation found that the Applicant Firm's application was not complete, as required by NASD Rule 1014(a)(1). We affirm.

During the course of the application, the Applicant Firm repeatedly amended both its proposed system of supervision and its proposed organizational structure. Between September 2009 and May 2010, the Applicant Firm proposed a total of four different supervisory structures, along with changes to the organizational structure that necessarily impacted any assessment of the supervisory system:

- The September 2009 initial proposal reflected that the Applicant Firm would engage in a range of business activities; that the Applicant Firm did not anticipate opening additional offices besides the main office; that Person 1 would be president and designated principal; that Person 3 would be the chief compliance officer and would supervise the OSJ and any registered branch officers; and that Person 2 would be the FINOP.

- The February 2010 proposal reflected that the Applicant Firm was reducing its proposed business lines to just mergers and acquisitions and private placements; that the Applicant Firm might open as many as three branch offices; and that Person 4 would join the Applicant Firm in a "[s]upervision/[n]on [s]ales" capacity.

- The April 2010 proposal—more than six months after the initial application—reflected that Person 1 would now be the Applicant Firm's president, chief compliance officer, primary supervisor, "sole director," executive representative, and anti-money laundering "officer"; that Person 1 would directly supervise all securities businesses; that Person 3's role would be limited to "secondary principal"; that Person 5 would be an "alternate principal"; that Person 4 was no longer in the supervisory picture; and that Person 6 would join the Applicant Firm as a producing representative.

- The May 2010 proposal—more than eight months after the initial application—clarified that Person 6 would be working out of a State 2 office and introduced Person 9 as a possible branch office principal of that office.

With each amendment, the Applicant Firm introduced changes to the proposed business lines, the lineup of principals, the number and location of its offices, the supervisory assignments, or the representatives. Each change would have impacted any assessment of the supervisory structure.[18] Moreover, the Applicant Firm continued to make substantial amendments very late in the process, including changes that the Applicant Firm had not even committed to make, such as the possible hiring of Person 9. Adding further confusion, the Applicant Firm often proposed changes in correspondence with Member Regulation without making corresponding amendments to its other application materials. We agree with Member Regulation that the "repeated changes to the supervisory structure, particularly those occurring late in the application process, demonstrate that [the Applicant Firm] has still not conclusively decided who the principals will be" and that "consequently . . . the application is not complete."

The Applicant Firm attempts to minimize the changes it made. For example, it argues that the "core individuals, those being Person 1, Person 3, and Person 2, did not change," and that the April 2010 changes with respect to Person 3 and Person 1 were simply "a change in the titles." The Applicant Firm's responses, however, indicate that the April 2010 amendments involved a material change in Person 1's and Person 3's substantive responsibilities, including shifting the oversight of any OSJs and registered branch offices and chief compliance officer duties from Person 3 to Person 1. As another example, the Applicant Firm claims that its May 2010 identification of Person 9 was "a matter of full disclosure to prevent FINRA from alleging . . . that we misrepresented the application," and that "[i]t was not our desire or intention to change the supervisory structure at the time." The Applicant Firm's floating of Person 9 as a possible new principal, however, was significant, because it shows that, deep into the application process, the Applicant Firm was contemplating making a supervisory change at the only office that would generate any securities activity.

The Applicant Firm also argues that the repeated changes reflected direct responses to concerns that Member Regulation had raised during, and late into, the application process, and it blames FINRA for not raising its concerns earlier or with more specificity. In this regard, the Applicant Firm contends that FINRA "should provide assistance" to an applicant for new membership, argues that "the principal examiner was not experienced enough . . . to ask the

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[18] *See, e.g.*, NASD Rule 1014(a)(10)(A) (requiring Member Regulation to consider, as part of its evaluation of the adequacy of a supervisory system, the supervisory personnel, the persons to be supervised, the offices, and the nature and scope of business to be conducted at each office).

necessary questions . . . early in the process," and complains that it "[could not] get an answer" about concerns that Member Regulation had raised that Person 1 did not meet the experience standard in NASD Rule 1014(a)(10)(D).[19] The Applicant Firm summarizes that its changes reflected an "evolving" structure and that an applicant for new membership "should be allowed to amend [its] application within reason to address regulatory concerns presented by FINRA without it jeopardizing the decision."

These arguments do not persuade us, however, that the Applicant Firm's application was ever complete. The new membership application process allows for some flexibility in an application. Member Regulation can raise concerns with an applicant's proposal, and an applicant can attempt to satisfy such concerns in response. Such flexibility ensures that applicants for membership receive a fair opportunity to hone an application to demonstrate that it can operate in a manner consistent with the public interest and the protection of investors. Indeed, we credit Person 1's testimony that many of the Applicant Firm's amendments reflected its attempts to respond to regulatory concerns raised by Member Regulation.

We agree with the position advanced by Witness 2 at the hearing, however, that at some point an application must reach substantially a point of rest to be deemed complete. The Applicant Firm's application never reached that point. More than six months after the application was filed—i.e., after Member Regulation's original deadline for issuing the decision—the Applicant Firm proposed sweeping changes to its supervisory system. It proposed additional changes eight months after the initial application. Even at the hearing, the Applicant Firm remained non-committal about whether it would hire Person 6 or Person 9. Such circumstances compel the conclusion that the Applicant Firm decided to seek FINRA membership before it had established a solid business foundation, and that even the Applicant Firm's last proposal likely does not demonstrate what the Applicant Firm's supervisory structure—or supervisory needs—will look like in the near future.[20]

The Applicant Firm's blaming of FINRA's principal examiner for the Applicant Firm's repeated amendments also is unpersuasive. The Applicant Firm's view is that FINRA is required to play a consultative role with respect to an applicant for new membership. While Member

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[19] NASD Rule 1014(a)(10)(D) requires Member Regulation to consider, as part of its evaluation of the adequacy of a supervisory system, whether "each Associated Person identified in the business plan to discharge a supervisory function has at least one year of direct experience or two years of related experience in the subject area to be supervised." Although Member Regulation initially raised concerns that Person 1 did not have the requisite experience, its decision did not rely on any such concerns.

[20] Indeed, Person 1 testified that "I wanted to set up the broker-dealer first before I marketed these services to the independent investment bankers."

Regulation may opt to do so, such as when it benefits the efficiency of the overall membership application process, it is not mandated by the rules. Rather, it is the Applicant Firm's burden to demonstrate that its application meets the standards for new membership, not FINRA's.[21]

The Applicant Firm also argues that its late identification of Person 6 is not evidence of an incomplete application, contending that "[r]epresentatives are hesitant to commit to a firm that is not yet approved." Regardless of any such practical difficulties, the Applicant Firm should have known that failing to identify even a single producing representative earlier in the process could adversely impact its application's prospects, especially considering that its proposed business model is to have a broker-dealer "platform" with which so-called "independent investment bankers" would associate. *See* NASD Rule 1014(a)(10)(A) (requiring Member Regulation to evaluate the adequacy of the supervisory system "in light of the number, location, experience, and qualifications of persons to be supervised"). The regulatory concern posed by such uncertainty is exemplified by the fact that, when the Applicant Firm finally identified Person 6, its supervisory needs crystallized and changed dramatically.[22] Given the effect that identifying just one proposed producing representative had, we are unable to conclude that the Applicant Firm's proposed system of supervision has reached a point of rest, especially considering that as many as nine additional representatives and their locations remain unknown.

Accordingly, we affirm Member Regulation's finding that the application is not complete, as required by NASD Rule 1014(a)(1).

B. NASD Rule 1014(a)(10)

Member Regulation also found that the Applicant Firm failed to demonstrate that it has an adequate supervisory system, as required by NASD Rule 1014(a)(10). We agree.

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[21] We also expressly reject the Applicant Firm's argument that principal examiner Witness 1 was "inexperienced." Witness 1 credibly testified that she is a 12-year veteran of FINRA with eight years' experience reviewing new membership applications, including approximately 50 applications from firms seeking to engage in mergers and acquisitions work. Although Witness 1 was not familiar with actual examples of violations by mergers and acquisitions firms, she ably testified about examples of various regulatory concerns that such activities present. Likewise, we do not credit Person 1's testimony that Witness 1 had previously told him that she was not aware of the disciplinary issues that can arise at a mergers and acquisitions firm.

[22] As explained in the next section, when the Applicant Firm identified Person 6, it became clear that the Applicant Firm faced the prospect of supervising a person who was new to the securities industry, geographically distant from the OSJ that would supervise him, in charge of his own office, and possibly engaging in foreign securities activities.

Rule 1014(a) and (a)(10) provide that, in evaluating the adequacy of a supervisory system, we are to consider the "public interest and the protection of investors," "the overall nature and scope of the Applicant's intended business operations," and a number of other specific factors. Member Regulation found that three other factors provided grounds for finding that the Applicant Firm's supervisory system was inadequate: NASD Rule 1014(a)(10)(A), (a)(10)(G), and (a)(10)(J). NASD Rule 1014(a)(10)(A) requires that we consider whether "the number, location, experience, and qualifications of supervisory personnel are adequate in light of the number, location, experience, and qualifications of persons to be supervised; . . . and the number and locations of the offices that the Applicant intends to open and the nature and scope of business to be conducted at each office." NASD Rule 1014(a)(10)(G) requires that we consider whether "the location or part-time status of a supervisor or principal will affect such person's ability to be an effective supervisor." NASD Rule 1014(a)(10)(J) requires that we consider whether there is "any other condition that will have a material impact on the Applicant's ability to detect and prevent violations of the federal securities laws, the rules and regulations thereunder, and FINRA rules."

The Applicant Firm's proposal to employ Person 6—the only producing representative identified—raises numerous supervisory challenges. Person 6 has some non-securities experience in mergers and acquisitions, but we give that fact far less weight than the fact that he is new to the securities industry and, from the Applicant Firm's vantage point, would be untried personnel. *Cf. Richard F. Kresge*, Exchange Act Rel. No. 55988, 2007 SEC LEXIS 1407, at *30 (June 29, 2007) (stating that "[w]e have often stressed 'the obvious need to keep [a] new office with . . . untried personnel under close surveillance'" and implying that hiring a representative with "less than two years experience" creates a similar need). The fact that Person 6's State 2-based office would be geographically distant from the State 1 office that would supervise his activities poses additional supervisory hurdles. *Cf. NASD Notice to Members 98-38* (May 1998) (stating that to fulfill its supervisory obligations over "unregistered offices"—i.e., offices that are neither OSJs or branch offices—a "firm should consider whether the number and location of its registered principals provides the capability to supervise its unregistered office personnel effectively").[23]

The Applicant Firm has not presented a plan of supervision that adequately meets the challenges posed by employing Person 6. The Applicant Firm explained that it would monitor Person 6's (and his support personnel's) electronic communications using an e-mail monitoring

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[23] Attempting to minimize Person 6's lack of securities experience, the Applicant Firm emphasizes that Person 6 "demonstrated his knowledge of the industry by having successfully passed a qualifying examination within 30 days." Person 6 has passed only the corporate securities limited representative (Series 62) examination, however, not the Series 79 examination that would qualify him to engage in mergers and acquisitions securities work.

system, would review all documents related to any possible securities transaction using an online document repository, and would conduct "spot checks" during visits to Person 6's office. Problematically, however, the Applicant Firm has no plan for supervising Person 6's in-person or phone securities solicitation activities.[24]

Moreover, the Applicant Firm has not convincingly demonstrated that either Person 1 or Person 9—were the Applicant Firm to eventually hire her—could supervise effectively Person 6. Person 1 would shoulder essentially all of the supervisory responsibilities, yet he intends to work only part-time and to continue committing most of his working hours to his consulting business. Person 1's location in State 1 also will impact how effective his remote supervision of Person 6 could be. Moreover, Person 1's purported backup principals would provide only limited supervisory support: Person 3 intends to commit only 10 hours per month to the Applicant Firm, Person 5 would supervise on only an "as needed basis," and both would continue to have outside work commitments.[25] As for Person 9, her ability to supervise effectively Person 6 is compromised considering that she serves in a subordinate role to Person 6 at another organization with which they are jointly associated.[26] Moreover, as Witness 2 testified, Person 6 is "not your average rep." Person 6 appears to be in charge of his office: he conducts separate business operations from it, employs at least two junior investment bankers there, and is in negotiations to hire his own branch office manager. We agree with Member Regulation's finding that these circumstances "call[ ] into question the effectiveness of any supervision that would be . . . provided by Person 9 and/or Person 1."

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[24] NASD Rule 3010(c)(1) requires member firms to periodically examine customer accounts to detect and prevent irregularities and abuses. Among the things that firms may consider doing to meet such obligations is to "review[ ] the registered representative's customer contacts by . . . monitoring selected telephone conversations between the registered representative and both existing and potential customers or attending meetings between the representative and his or her clients." *See NASD Notice to Members 97-19* (Apr. 1997) (discussing heightened supervisory procedures for certain registered representatives).

[25] Noting that it has named three general securities principals and a FINOP, the Applicant Firm argues that "[i]n many instances, FINRA grants a waiver from the two principal requirement [in NASD 1021(e)] if the member will have less than 10 registered representatives." We give little weight, however, to the fact that the Firm has not sought to waive the two principal requirement, considering that all the named principals will work on limited part-time schedules and maintain substantial outside commitments.

[26] At the hearing, Person 1 acknowledged that Person 9 "works for" Person 6 at that networking organization.

The Applicant Firm's supervisory system also does not adequately account for Person 6's foreign activities. The preponderance of the evidence suggests that Person 6's foreign business activities may involve securities transactions and that the Applicant Firm may permit him to engage in foreign private securities transactions.[27] Nothing in the Applicant Firm's written supervisory procedures explains, however, how the Applicant Firm would supervise any such foreign securities business.[28]

Finally, our overall concerns with the proposed supervisory system are compounded by the Applicant Firm's failure to identify where its other offices might be located or who its other representatives might be. The inadequacy of the supervisory system would only be exacerbated should the Applicant Firm decide to open a second and third office that is also geographically distant from its main office or employ additional representatives like Person 6.

The Applicant Firm makes several arguments in support of its supervisory system. The Applicant Firm argues that the nature and volume of the Applicant Firm's business activities would not require Person 1's full-time attention.[29] Mergers and acquisitions work, however, is a

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[27] The Applicant Firm has represented that a number of Person 6's projects have involved "companies based in Europe and Asia and he is currently opening strategic activities in India." In engaging in such foreign business activities, Person 6 "provides business advisory and M&A consulting services to non-US entities and natural persons residing in several countries." The Applicant Firm wrote that "[i]n all cases such engagements will be disclosed to the Applicant Firm and *where applicable under its supervision as documented in the [written supervisory procedures]*." (Emphasis added.) The Applicant Firm's written supervisory procedures, in turn, contain a section concerning "private securities transactions," which indicate that the Applicant Firm will supervise any representative's participation in private securities transactions as if the transaction were executed on behalf of the Applicant Firm.

[28] In its notice of appeal, the Applicant Firm contends that Member Regulation's concerns with Person 6's foreign activities are premised on a "misunderstanding." It asserts, among other things, that such overseas activities have not involved issuing or marketing securities or acting as a broker-dealer, and that Person 6 will continue to refrain from engaging in any such activities. We give these representations little weight, however, given that Person 1 testified that he had yet to complete his "due diligence" review of Person 6's foreign activities.

[29] In this regard, the Applicant Firm notes that: (1) the Applicant Firm would employ less than 10 registered representatives involved in sales, an amount within the safe harbor provision; (2) that each representative is "expected to do only a few transactions per year," and likely "less than five"; (3) that a mergers and acquisitions transaction "develops over an extended period of time" and does not require "immediate supervisory approval"; and (4) that its anticipated mergers and acquisitions work involve "two parties" who are "accredited" or "institutional" parties and, therefore, presents "lower risk than [the business of] your typical retail broker-dealer[ ]."

relatively complex undertaking. Person 1 testified that the average mergers and acquisitions deal would ordinarily take three to four months to complete, and he acknowledged that "[t]here's a lot of work that's involved." To supervise mergers and acquisitions work effectively—even at the volume that the Applicant Firm anticipates—would likely require a more sustained familiarity with potential deals than could be achieved through limited, part-time, remote monitoring by one primary supervisor. And while the Applicant Firm's business may not entail working with retail customers, mergers and acquisitions and private placement businesses that are marketed to institutional or accredited investors are not immune from potential violations.

Person 1 also tried to downplay the significance of not having procedures to monitor telephone and in-person contacts, testifying that "[t]elephone solicitation is typically not a major area of concern with . . . [M&A] transactions." But he undercut his own testimony by admitting that such work *would* involve telephone contact between a representative and a client. Indeed, the nature of mergers and acquisitions deals involves numerous stages that would likely involve at least some amount of telephone or in-person contact with customers and potential customers (whether buyers or sellers) and actual or potential counterparties.[30] Moreover, even the Applicant Firm's own procedures concerning mergers and acquisitions business and private placements contain numerous *restrictions* on contacts with potential investors that would require some supervision of Person 6's telephone and in-person contacts.[31]

Person 1 also argues that he has the flexibility to reduce his outside business activities to free up additional time for the Applicant Firm, and that, as a former regulator, he "is fully aware of his obligations and responsibilities to the Applicant and the public." Person 1's commitment

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[30] *See, e.g.*, FINRA, *Content Outline for Investment Banking Representative Qualification Examination*, at 17-20 (2009), *available at* http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/industry/p119446.pdf (indicating that: (i) sell-side mergers and acquisitions transaction stages include "setting up the process," "marketing the transaction," "managing the bidding process," and "executing the transaction" stages; (ii) buy-side transaction stages include pre-bid analysis, the "bidding process," and "executing the deal"; and (iii) both buy-side and sell-side transactions include preparation of "fairness opinions" and signing-to-closing stages).

[31] The Applicant Firm's procedures provide that, when offering private placements or when acting as a finder for mergers and acquisitions, "[c]old calling is not permitted" and seminars and meetings are restricted. The procedures further require, for private placements, that a representative "must approach only prospective investors with whom the Applicant Firm or an issuer has a 'substantive, pre-existing relationship," and "must wait a reasonable period of time before approaching [a] prospective investor to determine whether he or she has an interest in an offering."

to reduce his consulting work as needed is too vague to be meaningful. For example, Person 1 has not quantified in any way how much he was prepared to cut back his consulting assignments.

The Applicant Firm also argues that Member Regulation has granted new membership applications that were analogous to the Applicant Firm's. The Applicant Firm failed, however, to demonstrate any such analogous situations. For example, Person 1 testified that in August 2008, FINRA purportedly granted a new membership application submitted by his client that identified only a "platform" for oil and gas business activities and that had not identified any registered representatives or offices that would conduct sales activity. Even if true, there is no evidence whether such application also involved the kinds of regulatory concerns that are present here, such as a roster of part-time principals to provide remote supervision over an individual who is brand new to the industry. Moreover, unlike the application about which Person 1 testified, the Applicant Firm *has* provided information about at least one office and representative.

In another attempted analogy, the Applicant Firm defends its plan to supervise Person 6 from afar, arguing that "[t]here are numerous broker-dealers who have representatives in states that have no principal physically present in every office and there is no rule requiring that." In support of that, the Applicant Firm pointed to no specific analogous situations. Moreover, we find that the Applicant Firm's plan to operate the State 2 office as an unregistered office without an on-site principal—instead of as an OSJ, which would require an on-site principal—raises significant questions under FINRA rules. *See* NASD Rule 3010(a)(4). NASD Rule 3010(a)(3)(C) requires firms to consider whether a "location is geographically distant from another OSJ of the firm" when determining whether to designate such a location as an OSJ. In addition, NASD Rule 3010(g) provides that an OSJ includes any office of a firm at which "structuring of . . . private placements" takes place. Person 6's proposed business activities include private placements that are needed to complete certain mergers and acquisitions work, and the Applicant Firm explained that, "[i]n the process of making introductions between buyers and sellers, the [Firm's] registered representatives may provide information regarding potential financing structure." The Applicant Firm has not addressed in a satisfactory manner why such facts and circumstances would not require the Applicant Firm's State 2 office to be designated as an OSJ.[32]

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[32] In another failed analogy, Person 1 argues that FINRA has purportedly approved new membership applications in which the applicants proposed employing principals who were registered with multiple firms. In support of that argument, the Applicant Firm introduced BrokerCheck® reports for two persons who are registered with multiple firms, primarily as FINOPs. However, Person 1 did not know if either person shouldered the same kind of management and ownership responsibility at their broker-dealers that he would at the Applicant

[Footnote continued on next page]

The Applicant Firm emphasizes that its supervisory plan reflects numerous responses to regulatory concerns that Member Regulation identified throughout the application process. For example, the Applicant Firm notes that, in response to Member Regulation's concerns, it scaled back its business model to include just mergers and acquisitions business and private placements. Regardless of the Applicant Firm's motivation for amending certain elements in its supervisory plan, however, the end result—or at least the last version that the Applicant Firm proposed—is not sufficiently designed to prevent and detect violations of the securities laws, the rules and regulations thereunder, and FINRA Rules. We therefore affirm Member Regulation's finding that the Applicant Firm failed to meet the standard in NASD Rule 1014(a)(10).

IV. Conclusion

The Applicant Firm failed to demonstrate it meets the standards of membership contained in NASD Rule 1014(a)(1) and (a)(10). Accordingly, Member Regulation's decision to deny the Applicant Firm's application for FINRA membership is affirmed.[33]

On Behalf of the National Adjudicatory Council,

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Marcia Asquith
Senior Vice President and Corporate Secretary

[cont'd]

Firm. Moreover, the Applicant Firm offered no other details about such other broker-dealers' proposed supervisory structures that would permit any kind of comparison.

[33] We have considered and reject without discussion all other arguments advanced by the applicant.