

**INFORMATIONAL****Membership Rules**

SEC Approves  
Amendments To NASD  
Membership Rules;  
**Effective Date:  
November 15, 2000**

**SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Legal & Compliance
- Senior Management

**KEY TOPICS**

- IM-1011-1
- Membership Rules
- New Member Applicants
- Membership Agreements
- Rule 1011
- Rule 1012
- Rule 1013
- Rule 1014
- Rule 1015
- Rule 1016
- Rule 1017
- Rule 1018
- Rule 1140

**Executive Summary**

On August 15, 2000, the Securities and Exchange Commission (SEC) approved rule changes by the National Association of Securities Dealers, Inc. (NASD® or Association) that amend the Rule 1010 Series (Membership Rules or Rules) which governs the NASD membership application process. The amendments are designed to streamline and reorganize the current rules to make them more efficient for member firms and new applicants while preserving their investor protection function.

The amendments include the following changes:

- adopting new definitions under Rule 1011 for “material change in business operations,” “principal place of business,” and “sales practice event”;
- adopting Interpretive Material 1011-1, which creates a safe harbor for certain business expansions that are presumed not to be material changes and therefore do not require a firm to file an application pursuant to amended Rule 1017;
- simplifying administrative procedures for submitting an application and calculating the various applicable time limits;
- permitting the staff to immediately reject applications that are not substantially complete; and
- adopting new requirements for applicants to submit information concerning communications and operational systems to ensure business continuity.

In addition, current Rules 1017, “Removal or Modification of Business Restriction,” and 1018,

“Change in Ownership, Control or Operations,” are consolidated into an amended Rule 1017.

Revisions also will be made to the reference documents, *How To Become A Member Of The National Association of Securities Dealers, Inc.* and *A Guide to Areas of Inquiry in Continuing Membership Applications and Applications to Remove or Modify Restrictions* to conform them to the amended rules. Both revised documents will be found on the NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) Web Site ([www.nasdr.com](http://www.nasdr.com)) after the rule amendments become effective.

The rule changes are included with this *Notice* (see Attachment A). These changes become effective on November 15, 2000.

**Questions/Further Information**

Questions concerning this *Notice* may be directed to Jeffrey S. Holik, Vice President and Director of Regulation Policy, Department of Member Regulation, NASD Regulation, at (202) 728-8387, or by e-mail at: [jeffrey.holik@nasd.com](mailto:jeffrey.holik@nasd.com), Allison Reid, Membership Manager, Department of Member Regulation, NASD Regulation, at (202) 728-6954, or by e-mail at: [allison.reid@nasd.com](mailto:allison.reid@nasd.com), or Gregory Dean, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8159, or by e-mail at: [gregory.dean@nasd.com](mailto:gregory.dean@nasd.com).

**Background**

Beginning in August 1998, NASD Regulation staff worked with the Membership Admission Review Committee (Committee),<sup>1</sup> an ad-hoc committee convened to identify and recommend changes, if

appropriate, to the Membership Rules in order to clarify and streamline the Rules while preserving their investor protection function. The Committee's recommendations were published in *Notice to Members 99-67*, "NASD Requests Comment On Proposed Amendments To Membership Rules" (August 1999).

Based upon comments received, the proposals were revised and submitted to the SEC. The SEC approved the publication of the proposals for comment on June 1, 2000.<sup>2</sup> On August 15, 2000, the SEC issued an order approving the proposed amendments to the Membership Rules.<sup>3</sup>

The most significant changes are as follows:

- reorganizing and consolidating some of the current rules to make them easier to use;
- clarifying the rules and policies for members' business expansions that are intended to provide more certainty to members regarding the types of expansions not requiring approval, while at the same time, preserving flexibility to allow NASD Regulation staff to review the more significant changes in members' businesses. This is achieved by:
  - ◆ adopting a policy of building members' expansion plans into membership agreements;
  - ◆ providing more guidance in the rules about the types of "material changes in business operations" that will require a member to file an application for approval with NASD Regulation; and

- ◆ providing a safe harbor for certain business expansions that will be presumed not to be material changes, and therefore, do not require members to file an application for approval;

- requiring applicants to submit information concerning communications and operational systems to ensure business continuity;
- simplifying administrative procedures for submitting an application and calculating the various applicable time limits that apply to the process;
- permitting the staff to reject immediately applications that are not substantially complete; and
- rescinding permanently the National Adjudicatory Council's (NAC) authority to review membership decisions that are not appealed by an applicant.

Below are the detailed explanations of the amendments.

### **Rule 1011 – Definitions**

The definition of "Associated Person" is amended to clarify that it includes only natural persons.

The term "principal place of business" is defined for the first time. An applicant's principal place of business determines which NASD Regulation District Office (District Office) will process its application. "Principal place of business" means the location where the officers, partners, or managers direct and control the activities of the applicant, unless NASD Regulation staff designates a different location based upon where the largest number of

associated persons are located or where the books and records are kept. This definition will provide more consistency and certainty regarding which District Office will process a firm's application.

NASD Regulation has redefined "sales practice violations" as "sales practice event." A sales practice event is one of the factors that NASD Regulation considers in determining whether an applicant satisfies the admission standard in Rule 1014(a)(3), which requires a showing that the applicant and its associated persons are capable of complying with, among other things, the federal securities laws and the Association rules. The new term is intended to encompass matters, including any customer complaint, arbitration, or civil litigation, that have been or are required to be reported to the Central Registration Depository (CRD<sup>SM</sup>) or otherwise are required to be reported to NASD Regulation (e.g., via reports pursuant to Rule 3070).<sup>4</sup> This change is in response to concerns that some items required to be reported to CRD or pursuant to Rule 3070 are not considered to be formal violations. While this change does not affect the existing review standards under Rule 1014, it does provide clarification to amended Rule 1014(a)(3)(B).

The terms "Applicant" and "Interested Association Staff" are also amended to conform them to other rule changes.

The term "material change in business operations" is being defined for the first time. The term is defined to include, but is not limited to, removing or modifying a membership agreement restriction;<sup>5</sup> market making, underwriting, or acting as a dealer for the first time; or adding business activities that

require a higher minimum net capital. All other expansions, including those categories of new business lines identified on Form BD, are to be evaluated on a facts and circumstances, case-by-case basis.

NASD Regulation does not believe that it is possible to develop an exhaustive definition of the term “material change in business operations.”<sup>6</sup> If a change in a member’s business falls outside of the definition or the safe harbor provisions described below in Interpretive Material 1011-1 (IM-1011-1) (e.g., because it exceeded the safe harbor limits or the member has disciplinary history), then the member must determine whether, based upon all facts and circumstances, the change is material. A member may, but is not required to, contact the District Office to obtain guidance on this issue. Ultimately, the member is responsible for compliance with amended Rule 1017. If the staff determines that the change is indeed material, then the member potentially could be subject to disciplinary action for failure to file an application under Rule 1017.

In instances when a member intends to add a line of business, staff experience has shown that this type of expansion is often a significant event that has an impact on the firm’s supervisory and compliance infrastructure, personnel, and/or finances. When such an impact occurs, NASD Regulation staff is required under the rules to verify that the member continues to meet each of the membership criteria identified in Rule 1014.<sup>7</sup> However, NASD Regulation recognizes that the characterization of any proposed new business line as a “material change in business operations” ultimately depends on an

assessment of all relevant facts and circumstances, including:

- the nature of the proposed expansion;
- the relationship, if any, between the proposed new business line and the firm’s existing business;
- the effect the proposed expansion is likely to have on the firm’s capital;
- the qualifications and experience of the firm’s personnel; and
- the degree to which the firm’s existing financial, operational, supervisory, and compliance systems can accommodate the proposed new business line.

Based upon these factors, we believe that at least some proposed expansions by member firms into new areas of business would not constitute a material change and thus not trigger a review under amended Rule 1017. Certain proposed new business lines, such as market making, underwriting, and acting as a dealer for the first time, will invariably constitute a material change in business operations.

#### **Interpretive Material 1011-1 (IM-1011-1)**

IM-1011-1 is added to create a safe harbor for certain changes that are presumed not to be a “material change in business operations,” and therefore do **not** require a member to submit an application pursuant to amended Rule 1017 for approval of the change. The safe harbor was created out of the recognition that firms need to be able to grow while essential investor protections are maintained.

The safe harbor is intended to balance these needs while allowing firms to file and NASD Regulation staff to review those proposed business expansions that are most likely to affect the financial, compliance, and/or internal control systems of firms. Firms with certain membership agreement restrictions or a disciplinary history would not be able to use the safe harbor.

The safe harbor is available to those firms that do not have a membership agreement and to those firms that have a membership agreement but the agreement does not contain a restriction on the permissible expansion areas of the safe harbor (number of associated persons involved in sales, number of offices, and number of markets made). The safe harbor is not available to a firm that has a specific restriction in its membership agreement on any one of those three areas of expansion. Similarly, if a firm has a membership agreement that already permits greater expansion levels than permitted by the safe harbor, then membership agreement levels take precedence over the safe harbor levels. In both of these situations, NASD Regulation staff have already evaluated a firm’s systems and procedures and the staff have incorporated the restrictions or expansion plans into the membership agreement.

If a proposed expansion is outside of the safe harbor provisions, it does not necessarily mean that the expansion is a “material change in business operations.” The safe harbor provisions are meant to provide guidance on what changes will not be considered material. Whether changes and expansions outside of the safe harbor provisions are material will need to be determined on a case-by-case

basis by reviewing the particular facts and circumstances. A member may, but is not required to, contact its District Office to obtain guidance on this issue.

In addition, the safe harbor would not be available to members that have a defined "disciplinary history."<sup>8</sup> A member with a disciplinary history as defined by IM-1011-1 does not necessarily need to apply under amended Rule 1017 for every business expansion. Again, whether changes and expansions to be undertaken by a firm with "disciplinary history" are material would be determined on a case-by-case basis.

### **Rule 1012 – Filing By Applicant Or Service By The Association**

NASD Regulation has amended the service and filing provisions to permit additional methods of delivery and to use consistent terminology for calculating deadlines. The term "commercial courier" is replaced with "overnight courier" to clarify that applicants and NASD Regulation staff may use the overnight delivery service offered by the United States Postal Service. NASD Regulation interprets the term "overnight courier" to refer to any entity that regularly provides overnight delivery services, such as Federal Express, DHL, or the United States Postal Service. Use of the term "overnight courier" is not intended to imply that only actual overnight delivery may be used under the Rule. Overnight delivery should be used if it is available. However, if overnight delivery is not available for a particular location, the applicant or NASD Regulation staff may use the most rapid delivery option available (e.g., two-day

service) from the overnight courier and still be in compliance with the Rule.

Throughout the amended Rules, the term "file" is used uniformly to refer to submissions by an applicant, and the term "serve" is used uniformly to refer to delivery of requests, decisions, and the like by the Association. These terms replace other terms, such as "issuance" and "receipt."<sup>9</sup> These changes provide greater clarity and consistency in calculating deadlines in accordance with amended Rule 1012(a).

### ***"Lapse Of Application" Provisions***

The "lapse of application" provisions are consolidated and moved from existing Rules 1013(b), 1017(c), and 1018(d) to amended Rule 1012(b) for ease of reference. The lapse rule permits the staff to discontinue processing an application if an applicant does not timely provide requested information or documents. If the information or documents are not timely provided, then the rule permits the staff to "lapse" the application. The staff then notifies the applicant that the application has lapsed, all fees are forfeited, and the applicant is required to start over with the application process if it still wants to pursue the application.

The changes to the lapse rule also are designed to permit the staff and the applicant to agree on a submission date for the executed membership agreement, rather than requiring that all signed agreements be submitted within 25 days. In addition, the changes clarify that application fees are not refunded for lapsed applications.

### **Rule 1013 – New Member Application And Interview**

#### ***Application Submission Procedures***

One of the major changes to amended Rule 1013 is to simplify the application submission procedures. Currently, Rule 1013 requires applicants to submit their applications in two parts. Part One, which includes primarily forms and fees (e.g., the initial Forms BD and U-4), is sent directly to the CRD in Rockville, Maryland, for processing. Part Two, which includes all remaining documents required for member admission, is sent to the District Office that will review the application. At the time the Rule was initially adopted, the staff thought it would be more efficient to send each part to the location where it would be processed. In practice, this has created problems when both parts of the application are not submitted at the same time, or one or both parts are incomplete, making it difficult to determine when the application should be treated as filed. Determining the application filing date is critical in order to meet the requirement that a decision on the application be rendered within 180 days.

To alleviate this problem, Rule 1013 has been amended to create one point of entry for the entire application, the District Office.

#### ***Procedures For Applications That Are Not Substantially Complete***

NASD Regulation has added subparagraph (a)(4) to amended Rule 1013 for handling applications that are not substantially complete at the time of submission. Currently, the staff does not have any express authority in the existing rule to refuse to begin processing

an incomplete application. Instead, NASD Regulation staff attempts to begin processing such an application by sending a request for further information to the applicant.

Under the amended rule, if an application is so deficient upon initial submission that the staff cannot begin conducting a meaningful review, then the staff may reject the application and deem it to not have been filed. The staff must make this determination within 30 days after submission, and is required to provide reasons for its action in writing. NASD Regulation will assess a \$350 processing fee for the rejection of an application that is not substantially complete. NASD Regulation considered but rejected defining the term “substantially complete” because the determination will vary depending on, among other things, the type and complexity of the proposed business.

Amended Rule 1013 also is simplified for applicants by removing requirements that they submit information that has already been provided to CRD because District Office staff has full access to CRD. This change will make the application process simpler for applicants by eliminating duplicate submissions.

#### ***Initial And Subsequent Document Filings***

Under Rule 1013(a)(2), an applicant will continue to submit only its initial Forms BD and U-4 in paper along with the rest of the application. Under amended Rule 1013(a)(3), the applicant must make all subsequent Form filings and amendments electronically via Web CRD<sup>SM</sup>. Prior to making electronic filings, an applicant must seek and receive approval of the

Web CRD entitlement request form by NASD Regulation. This process is in conformity with SEC requirements for the submission of Form BD and amendments to it.<sup>10</sup> Conforming amendments have been made to Rule 1140.

#### ***New Membership Application Requirements***

##### ***Adequacy of Communication and Operational Systems***

New subparagraph (a)(2)(F)(xii) of amended Rule 1013 adds a new requirement for applicants to provide a description of the communications and operational systems that they will use to conduct business as well as plans and procedures they will employ to ensure business continuity. Included with the documentation should be information about the capacity to handle anticipated usage, contingency plans, and disaster recovery plans, among other things. In addition, this requirement has been formulated into a new standard for membership admission and has been added to requirements contained in Rule 1014. This new standard in amended Rule 1014 requires that such systems are adequate and provide reasonably for the business' continuity for each area set forth in amended Rule 1013(a)(2)(F)(xii).

It is not the staff's intention to investigate the adequacy of the systems, plans, and procedures; rather applicants, in order to demonstrate that their systems are adequate and will reasonably provide for business continuity, must file a certification as part of their application. The applicant may self-certify or may choose to rely on a third party (e.g., a vendor of such a system) to provide such certification.<sup>11</sup>

#### ***Updated Financial Information***

Rule 1013 is amended by adding new subparagraph (b)(5) to require applicants to provide updated financial information at the time of their membership interview. The updated information shall be prepared as of a date that is within 45 days before the interview.

#### ***Rule 1014 – Department Decision***

##### ***Standards For Admission***

As described above, Rule 1013 has been amended to require that the applicant submit a description of the communications and operational systems that the applicant will employ to conduct business and the plan and procedures to ensure business continuity. The amended Rule 1014 requires that such systems must be adequate and reasonably provide for business continuity before an application is approved.

In addition, Rule 1014 is amended to require that an applicant's supervisory procedures must specifically include procedures to ensure that proper registrations for principals and representatives are obtained by the firm.

The Committee and NASD Regulation also reevaluated the requirement of current Rule 1014(a)(9)(C) (amended Rule 1014(a)(10)(D)) that prospective supervisors have at least one year of direct experience or at least two years of related experience in the subject area to be supervised. It was determined that the supervisory experience requirements should not be increased at this time. Interpretive guidance on this matter has been published in *How To Become A Member Of The National*

*Association of Securities Dealers, Inc.*, which is available in the area for members on the NASD Regulation Web Site ([www.nasdr.com](http://www.nasdr.com)).

### **Submission Of Membership Agreements**

Rule 1014(c), which concerns the submission of membership agreements, is amended by deleting the requirement in subsection (c)(1) that all membership agreements contain an undertaking binding the member to “engage only in the business set forth in the business plan and the membership agreement.” NASD Regulation believes that the current rule was too restrictive, particularly for firms with no disciplinary history. The provision also puts members with a membership agreement at a disadvantage to members that do not have a membership agreement.<sup>12</sup> Henceforth, whether business expansions require approval by NASD Regulation will be governed solely by the requirements of amended Rule 1017.

When the amended Rules become effective, to ensure that members are treated equally, NASD Regulation will permit members that are eligible for the safe harbor to use it even if their membership agreement includes a general requirement to obtain approval from NASD Regulation of any change in business outside the terms of the agreement. When NASD Regulation examines a member, the membership agreement will be updated to reflect the new Rule.

In addition, when the Rule amendments become effective, NASD Regulation will begin, to the extent practicable, including business expansion plans in membership agreements. Members

that have not been through the membership review process or examined under the Rules adopted by the Association in August of 1997 and have existing restrictions in membership agreements, may want to contact their District Office to see if it would be appropriate to have the restriction removed.

### **Rule 1015 – Review By National Adjudicatory Council**

Under Rule 1015, an applicant can appeal an adverse District Office decision to the NAC. In addition, the NAC or the NAC Review Subcommittee may call for review a District Office decision on a membership application, even though no appeal has been filed by an applicant. NASD Regulation considered at length whether procedures or policies could effectively be developed to implement the call for review provision when no appeal was taken, but ultimately determined that developing such procedures and policies was not practicable.

NASD Regulation believes that the oversight function envisioned for the call for review provision is effectively performed through a variety of other existing mechanisms. The Department of Member Regulation (Department) employs a full time Membership Manager to coordinate and oversee the national program. Included in the Manager’s responsibilities is a quality control function. This function is carried out in several ways: maintenance of a Membership Procedures Manual; periodic advice memoranda sent to District Office staff (MAP Bulletins); regularly scheduled telephone conferences with District Office staff to discuss procedural and substantive issues arising in the program; and periodic training sessions for new and incumbent staff.

To supplement these tools, the Department’s Office of Quality Assurance conducts periodic peer reviews of the membership application program. The purpose of these peer reviews is to assess the District Offices’ application of the membership rules and procedures. The reviews include, among other things, spot checks of source documents to confirm the facts underlying the decisions.

In light of NASD Regulation’s national coordination and internal review procedures, Rule 1015 has been amended to delete the provision whereby the NAC or the NAC Review Subcommittee may call for review of a decision on a membership application made by the Department staff, even if the applicant does not appeal the decision.<sup>13</sup>

Rule 1015 has been amended to include a new paragraph (h) for dismissing appeals that are abandoned by an applicant, which includes, among other things, failing to appear at a hearing as set forth in current Rule 1015(f)(5), among other things.

### **Rule 1016 – Discretionary Review by NASD Board**

Conforming amendments are being made to Rule 1016.

### **Rule 1017 – Application For Approval Of Change In Ownership, Control, Or Business Operations**

Current Rule 1017, “Removal or Modification of Business Restriction,” and Rule 1018, “Change in Ownership, Control or Operations,” are consolidated in the amended Rule 1017. This change is being made to assist firms in filing and NASD Regulation staff in

reviewing applications for a change in firm ownership or control, or for a material change in the firm's business operations. Currently, a member may initiate business changes that involve both Rule 1017 and Rule 1018. This has created some confusion as to which rule should be used. By consolidating these rules, NASD Regulation anticipates making the process more efficient and effective for applicants and thus eliminating any confusion that may arise from the previously overlapping provisions. The consolidation of the two rules is achieved in part by defining, for the first time, the term "material change in business operations," in amended Rule 1011(i) to include certain types of business expansions as well as the removal or modification of a membership agreement restriction.

Amended Rule 1017 also sets forth additional documentation requirements for the review of an application (detailed below).

As provided in current Rules 1017 and 1018, an application and its accompanying documents need to be filed with the member's District Office. In the event of a merger between two members with principal places of business in two or more districts, the application must be filed and processed by the District Office where the surviving firm's principal place of business is located.

### ***Change In Ownership Or Control***

One type of change that triggers an application under amended Rule 1017 is a change in the equity ownership or partnership capital of the member that results in one person or entity owning or controlling 25 percent or more of the equity or partnership capital. NASD Regulation wishes to clarify that a group of individuals acting in

concert to obtain control of 25 percent or more of the equity or partnership capital of a member will be deemed to be an "entity" for purposes of the Rule, and as such, will trigger the requirement to submit an application to obtain approval of the ownership change.

In addition, NASD Regulation will discontinue its review of certain other types of changes. Under amended Rule 1017, NASD Regulation will discontinue review of member mergers and acquisitions that are reviewed by the New York Stock Exchange. This will eliminate duplicate reviews by self-regulatory organizations.

### ***Filing And Content Of Application Requirements***

Amended Rule 1017(b) sets forth for the first time what type of information should be included in an application for approval of a change in ownership, control, or business operations.

Paragraph (b) of amended Rule 1017 contains the initial content requirements and specifies where the application should be filed. Generally, this paragraph incorporates NASD Regulation's standard practices under current Rules 1017 and 1018. However, subparagraph (b)(2), for the first time, identifies items that must be included with an application. Specifically, the items include details on the change in ownership, control or business operations, including a business plan, pro forma financial statements, an organizational chart, and written supervisory procedures that reflect the change.

For applications requesting removal or modification of a membership agreement restriction, the content requirements of current Rule 1017(a) are carried forward in the

amended rule and will, therefore, still apply. In addition, the new documentation requirements of paragraph (b)(2) of amended Rule 1017 (detailed in the above paragraph) must be supplied with an application.

### ***Effecting Change And Imposition Of Interim Restrictions***

In addition, amended Rule 1017(c) sets forth the timing and conditions for effecting a change under amended Rule 1017. For a member that is filing an application for approval of a change in ownership or control, amended Rule 1017(c)(1) states that the application shall be filed at least 30 days before the event. A member may effect a change prior to the conclusion of NASD Regulation's review of the application or issuance of the Department's decision on the application; however, NASD Regulation may place new interim restrictions on the member based upon the standards contained in Rule 1014 pending final action.

For a member that is filing an application for the removal or modification of a restriction contained in a membership agreement, amended Rule 1017(c)(2) states that the change may not be effected until NASD Regulation has reached a decision. Until a decision has been reached, all existing restrictions must remain in place.

For a member's application seeking approval of a material change in business operations (other than for the removal or modification of a membership agreement restriction), the change will be effective upon the Department's decision approving the application. In addition, Rule 1017(c)(3) does allow the member to effect the change prior to NASD Regulation's

decision, but only with prior agreement of the Department.

### **Lapse Or Denial Of Application For Approval Of Change In Ownership**

NASD Regulation is adopting a new paragraph (k) to Rule 1017 to clarify the courses of action when an application for approval of a change in ownership lapses or is denied and all appeals are exhausted or waived. The rule change provides the member with a fixed period of time, 60 days, to submit a new application,<sup>14</sup> unwind the transaction, or file a Form BDW.

The Department may shorten the 60-day period for the protection of investors. In addition, the Department may lengthen the 60-day period upon good cause shown by the applicant. The Department may continue to place interim restrictions on the member during the 60-day (or extended) period. The purpose of the rule change is to clarify NASD Regulation's procedures and to ensure that proper investor protections are maintained. If a member operates outside or beyond the specified time period, then NASD Regulation may bring an action and/or seek the suspension or cancellation of the membership, as appropriate.

### **Rule 1018 – Reserved**

NASD Regulation has deleted the provisions contained in Rule 1018 and reserves this Rule number for future use.

### **Rule 1140 – Electronic Filing Rules**

Conforming amendments are being made to Rule 1140 to clarify that the initial filing of Forms under amended Rule 1013(a)(2) must be filed in paper form. All subsequent

filings must be filed through an electronic process.

### **Additional Guidance**

Revisions also will be made to the reference documents, *How To Become A Member Of The National Association of Securities Dealers, Inc.* and *A Guide to Areas of Inquiry in Continuing Membership Applications and Applications to Remove or Modify Restrictions* in order to conform them to the amended rules. Both revised documents will be found on the NASD Regulation Web Site ([www.nasdr.com](http://www.nasdr.com)) after November 15, 2000.

### **Endnotes**

<sup>1</sup>Members of the Committee were: Faith Colish, New York, New York; Linda Lerner, All-Tech Investment Group, Inc., Montvale, New Jersey; Brian T. Shea, Pershing, Division of Donaldson, Lufkin & Jenrette Securities Corporation, Jersey City, New Jersey; Theodore W. Urban, Ferris, Baker & Watts, Incorporated, Washington, D.C.; and Richard P. Woltman, Spelman & Co., Inc., San Diego, California. Mr. Urban chaired the Committee.

<sup>2</sup>Exchange Act Release No. 42885 (June 1, 2000), 65 Fed. Reg. 36860 (June 12, 2000), (File No. SR-NASD-99-67).

<sup>3</sup>Exchange Act Release No. 43157 (August 15, 2000), 65 Fed. Reg. 51377 (August 23, 2000).

<sup>4</sup>NASD Regulation has not made any changes to the definition of "sales practice violation" on the Form U-4.

<sup>5</sup>NASD Regulation included removing or modifying a restriction in this definition to facilitate the consolidation of current Rules 1017 and 1018. The rationale for the consolidation is set forth in the section titled "Rule 1017," below.

<sup>6</sup>Efforts were made during the Committee's deliberations to devise a comprehensive definition of "material change in business operations" that would provide members with greater certainty about when an application is required while affording staff the opportunity to review those proposed business expansions that were most likely to affect the financial, compliance, and/or internal control systems of the firm. After much thought and discussion, Committee members and NASD Regulation staff concluded that it was preferable not to develop a comprehensive definition of the term. Instead, the Committee recommended, and the amended rules provide, two measures designed to add greater clarity to the process and still preserve flexibility in applying the rule to individual situations: the adoption of IM-1011-1 to create a safe harbor for certain changes that are presumed not to be material and therefore do not require a member to submit an application; and the adoption of a non-exhaustive definition of "material change in business operations" that would alert members to some of the types of business expansions that can be expected to trigger the need to file an application.

<sup>7</sup>NASD Regulation staff tailors the scope of its review of proposed business expansions to the particular circumstances presented. In some cases, for example, when a firm seeks to expand into an area in which it already has relevant experience and comprehensive supervisory and internal controls, NASD Regulation's review would be more limited. In other cases, when a firm seeks to add a completely new business line unrelated to its current business mix, the scope of review could be more extensive.

<sup>8</sup>"Disciplinary history" means a finding of a violation by the member or a principal of the member in the past five years by the SEC, a self-regulatory organization, or a foreign financial regulatory authority of one or more of the following provisions (or comparable foreign provisions) or rules or regulations thereunder:

Sections 15(b)(4)(E) and 15(c) of the Securities Exchange Act of 1934 (failure to supervise; fraud and



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manipulation); Section 17(a) of the Securities Act of 1933 (fraudulent interstate transactions); SEC Rules 10b-5 (fraud and manipulation), and 15g-1 through 15g-9 (penny stock rules); NASD Rules 2110 (just and equitable principles of trade), 2120 (fraud and manipulation), 2310 (suitability), 2330 (protection of customer securities and funds), 2440 (fair prices and commissions), 3010 (failure to supervise only), 3310 (manipulative and deceptive quotations), and 3330 (payments to influence market prices); and MSRB Rules G-19 (suitability), G-30 (prices and commissions), and G-37(b) & (c) (political contributions).

<sup>9</sup>See, e.g., Rule 1013(a)(5) and (b)(1), Rule 1014(c)(3).

<sup>10</sup>See Exchange Act Release No. 41594 (Jul. 2, 1999), 64 Fed. Reg. 37586 (Jul. 12, 1999).

<sup>11</sup>See Exchange Act Release No. 42885 (June 1, 2000), 65 Fed. Reg. 36860 (June 12, 2000) at page 36874.

<sup>12</sup>In 1984, the SEC approved a codification of the NASD's member admission procedures, which included a requirement that any restriction on a member's business be included in a membership agreement executed by the member. See Exchange Act Release No. 21159, 49 Fed. Reg. 30268 (Jul. 27, 1984) (File No. SR-NASD-82-24). Thus, a member admitted before 1984 or a member admitted without any restriction from 1984 to 1997 may not have a membership agreement. In 1997, NASD Regulation began requiring all new members

to execute a membership agreement, regardless of whether NASD Regulation imposed any restriction. See NASD Rule 1014(c); Exchange Act Release No. 38908 (Aug. 7, 1997); 62 Fed. Reg. 43385 (Aug. 13, 1997) (File No. SR-NASD-97-28).

<sup>13</sup>Until these rule amendments go into effect, NASD Regulation has temporarily suspended calls for review of membership decisions and proposes to delete this provision. See Exchange Act Release No. 41311 (Apr. 20, 1999), 64 Fed. Reg. 20347 (Apr. 26, 1999) (File SR-NASD-99-15), for further explanation of this decision.

<sup>14</sup>A lapsed applicant may propose the same owners; a denied applicant must propose new owners.

**ATTACHMENT A**

(Note: New text is underlined; deletions are in brackets.)

**1010. Membership Proceedings****1011. Definitions**

Unless otherwise provided, terms used in the Rule 1010 Series shall have the meaning as defined in Rule 0120.

**(a) "Applicant"**

The term "Applicant" means a person [or entity] that applies for membership in the Association under Rule 1013[,] or a member that files an application [to remove or modify a restriction under Rule 1017, or files a notice and application for continuance in membership under Rule 1018] for approval of a change in ownership, control, or business operations under Rule 1017.

**(b) "Associated Person"**

The term "Associated Person" means: (1) a natural person registered under the Rules of the Association; or (2) a sole proprietor, partner, officer, director, branch manager, or other natural person occupying a similar status or performing similar functions who will be or is anticipated to be associated with the Applicant, or a natural person engaged in the investment banking or securities business who will be or is anticipated to be directly or indirectly controlling or controlled by the Applicant, whether or not any such person is registered or exempt from registration under the NASD By-Laws or the Rules of the Association.

**(c) "Department"**

The term "Department" means the Department of Member Regulation of NASD Regulation.

**(d) "Director"**

The term "Director" means a member of the NASD Regulation Board.

**(e) "district"**

The term "district" means a district established by the NASD Regulation Board.

**(f) "district office"**

The term "district office" means an office of NASD Regulation located in a district.

**(g) "Governor"**

The term "Governor" means a member of the NASD Board.

**(h) "Interested Association Staff"**

The term "Interested Association Staff" means an employee who directly participates in a decision under Rule 1014[,] or 1017, [or 1018,] an employee who directly supervises an employee with respect to such decision, an employee who conducted an investigation or examination of a member that files an application under Rule 1017 [or a notice and application under Rule 1018], the District Director for the relevant district, and the head of the Department.

**(i) "material change in business operations"**

The term "material change in business operations" includes, but is not limited to:

(1) removing or modifying a membership agreement restriction;

(2) market making, underwriting, or acting as a dealer for the first time; and

(3) adding business activities that require a higher minimum net capital under SEC Rule 15c3-1.

**[(i)](j) "NASD Board"**

The term "NASD Board" means the Board of Governors of the NASD.

**[(j)](k) "NASD Regulation Board"**

The term "NASD Regulation Board" means the Board of Directors of NASD Regulation.

**(l) "principal place of business"**

The term "principal place of business" means the executive office from which the sole proprietor or the officers, partners, or managers of the Applicant direct, control, and coordinate the activities of the Applicant, unless the Department determines that the principal place of business is where: (1) the largest number of Associated Persons of the Applicant are located; or (2) the books and records necessary to provide information and data to operate the business and comply with applicable rules are located.

**[(k)](m) "sales practice [violations] event"**

The term "sales practice [violations] event" means any [conduct directed at or involving a customer that would constitute a violation of any Rule in the Rule 2000 or 3000; any provision of the Act, Securities Exchange Act of 1934; or any state statute prohibiting fraudulent conduct in connection with the offer, sale, or purchase of a security or in connection with the rendering of investment advice] customer complaint, arbitration, or civil litigation

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that has been reported to the Central Registration Depository, currently is required to be reported to the Central Registration Depository, or otherwise has been reported to the Association.

### [(I)](n) “Subcommittee”

The term “Subcommittee” means a subcommittee of the National Adjudicatory Council that is constituted pursuant to Rule 1015 to conduct a review of a Department decision issued under the Rule 1010 Series.

### IM-1011-1. Safe Harbors for Business Expansions

This interpretive material concerns the types of business expansions that will not require a member to submit a Rule 1017 application to obtain NASD Regulation’s approval of the expansion. This safe harbor applies to: (1) firms that do not have a membership agreement, and (2) firms that have a membership agreement that does not contain a restriction on the factors listed below.

The safe harbor is not available to a member that has a membership agreement that contains a specific restriction as to one or more of the factors listed below. In that case,

the agreement takes precedence because NASD Regulation has determined that a particular restriction should apply as to one or more of the factors, and NASD Regulation has issued a decision with a rationale for that restriction. Similarly, the safe harbor also does not apply if the member has a membership agreement that permits expansion beyond the limits set forth below (e.g., an Applicant requests and obtains approval for ten registered representatives in the first six months with an additional ten registered representatives in the next year); in such case, the Department has specifically considered the firm’s expansion plans and approved them.

The safe harbor is not available to any member that has disciplinary history. For purposes of this Interpretation, “disciplinary history” means a finding of a violation by the member or a principal of the member in the past five years by the Securities and Exchange Commission, a self-regulatory organization, or a foreign financial regulatory authority of one or more of the following provisions (or a comparable foreign provision) or rules or regulations thereunder: Sections 15(b)(4)(E) and 15(c) of the Securities Exchange Act of 1934; Section

17(a) of the Securities Act of 1933; SEC Rules 10b-5 and 15g-1 through 15g-9; NASD Rules 2110, 2120, 2310, 2330, 2440, 3010 (failure to supervise only), 3310, and 3330; and MSRB Rules G-19, G-30, and G-37(b) & (c).

For those firms to which the safe harbor is available, the following types of expansions are presumed not to be a material change in business operations and therefore do not require a Rule 1017 application. For any expansion beyond these limits, a member should contact its district office prior to implementing the change to determine whether the proposed expansion requires an application under Rule 1017. Expansions in each area are measured on a rolling 12-month basis; members are required to keep records of increases in personnel, offices, and markets to determine whether they are within the safe harbor.

“Associated Persons involved in sales” includes all Associated Persons, whether or not registered, who are involved in sales activities with public customers, including sales assistants and cold callers, but excludes clerical, back office, and trading personnel who are not involved in sales activities.

	<b>Safe Harbor – Increase Permitted Within One Year Period Without Rule 1017 Application</b>
<b>Number of Associated Persons Involved in Sales</b> 1-10 ..... 11 or more .....	10 persons 10 persons or a 30 percent increase, whichever is greater
<b>Number of Offices (registered or unregistered)</b> 1-5 ..... 6 or more .....	3 offices 3 offices or a 30 percent increase, whichever is greater
<b>Number of Markets Made</b> 1-10 ..... 11 or more .....	10 markets 10 markets or a 30 percent increase, whichever is greater

**1012. General Provisions****(a) [Service of Notices and Decisions;] Filing by Applicant or Service by the Association**

[A notice or a decision issued by the Association under the Rule 1010 Series with respect to an application shall be served promptly by first-class mail on the Applicant or its counsel, unless a Rule specifies a different method of service. Service by the Association or filing by an Applicant by mail shall be deemed complete upon mailing. Service by the Association or filing by an Applicant by commercial courier or facsimile shall be deemed complete on the date specified in the written confirmation of receipt.]

(1) An Applicant may file an application or any document or information requested under the Rule 1010 Series by first-class mail, overnight courier, or hand delivery. If the Department and the Applicant agree, the Applicant also may file a requested document or information by facsimile.

(2) The Association shall serve a notice or decision issued under the Rule 1010 Series by first-class mail on the Applicant or its counsel, unless a Rule specifies a different method of service.

(3) Service by the Association or filing by an Applicant shall be deemed complete as follows:

(A) Service or filing by first-class mail shall be deemed complete on the date of postmark;

(B) Service or filing by overnight courier shall be deemed complete on the date of delivery to the overnight

courier as specified in the airbill;

(C) Service or filing by hand delivery shall be deemed complete on the date of receipt as evidenced by a date stamp; and

(D) Service or filing by facsimile shall be deemed complete on the date specified in the document and on the written confirmation of transmission.

**(b) Lapse of Application**

(1) Absent a showing of good cause, an application filed under Rule 1013 or 1017 shall lapse if an Applicant fails to:

(A) respond fully within 60 days after service of an initial written request for information or documents under Rule 1013, within 30 days after service of an initial written request for information or documents under Rule 1017, within 30 days after service of a subsequent written request for information or documents under Rule 1013 or 1017, or within such other time period agreed to by the Department and the Applicant;

(B) appear at or otherwise participate in a scheduled membership interview pursuant to Rule 1013(b) or 1017(f); or

(C) file an executed membership agreement under Rule 1014(d) or Rule 1017(g)(4) within 25 days after service of the agreement, or within such other period agreed to by the Department and the Applicant.

(2) If an Applicant wishes to continue to seek membership or approval of a change in ownership, control, or business opera-

tions, then the Applicant shall be required to submit a new application and fee under Rule 1013 or 1017, respectively. The Association shall not refund any fee for a lapsed application.

**[(b)] (c) Ex Parte Communications**

(1) The prohibitions against ex parte communications shall become effective when Association staff has knowledge that an Applicant intends to file a written request for review by the National Adjudicatory Council under Rule 1015.

[(1)] (2) Unless on notice and opportunity for an Applicant and Interested Association Staff to participate, or to the extent required for the disposition of ex parte matters as authorized by the Rules of the Association:

(A) an Applicant, a counsel or representative of an Applicant, or an Interested Association Staff shall not make or knowingly cause to be made an ex parte communication relevant to the merits of a membership proceeding under the Rule 1010 Series to a Governor, a member of the National Adjudicatory Council or a Subcommittee thereof, or an Association employee who is participating or advising in a decision of such a person with respect to that proceeding; and

(B) a Governor, a member of the National Adjudicatory Council or a Subcommittee thereof, or an Association employee who is participating or advising in the decision of such a person with respect to a membership proceeding shall not make or knowingly cause to be made to an Applicant, a counsel or rep-

representative of the Applicant, or an Interested Association Staff an ex parte communication relevant to the merits of that proceeding.

[(2)] (3) A Governor, a member of the National Adjudicatory Council or a Subcommittee thereof, or an Association employee participating or advising in the decision of such a person, who receives, makes, or knowingly causes to be made a communication prohibited by this paragraph shall place in the record of the membership proceeding:

(A) all such written communications;

(B) memoranda stating the substance of all such oral communications; and

(C) all written responses and memoranda stating the substance of all oral responses to all such communications.

[(3)] The prohibitions against ex parte communications shall become effective when Association staff has knowledge that an Applicant intends to file a written request for review by the National Adjudicatory Council under Rule 1015.]

#### **[(c)](d) Recusal or Disqualification**

A Governor or a member of the National Adjudicatory Council or a Subcommittee thereof shall not participate in a matter governed by the Rule 1010 Series as to which that person has a conflict of interest or bias, or if circumstances otherwise exist where his or her fairness might reasonably be questioned. In such a case, the person shall

recuse himself or shall be disqualified as follows:

(1) The Chair of the NASD Board shall have authority to direct the disqualification of a Governor, and a majority of the Governors of the NASD Board excluding the Chair shall have authority to direct the disqualification of the Chair of the NASD Board.

(2) The Chair of the National Adjudicatory Council shall have authority to direct the disqualification of a member of the National Adjudicatory Council or a member of a Subcommittee appointed pursuant to Rule 1015, and the Vice Chair of the National Adjudicatory Council shall have authority to direct the disqualification of the Chair of the National Adjudicatory Council.

#### **[(d)](e) Computation of Time**

##### **(1) Calendar Day**

In the Rule 1010 Series, "day" means calendar day.

##### **(2) Formula**

In computing a period of time under the Rule 1010 Series, the day of the act, event, default, or lapse from which the period of time designated begins to run shall not be included. The last day of the period so computed shall be included unless it is a Saturday, Sunday, or Federal holiday, in which event the period runs until the end of the next day that is not a Saturday, Sunday, or Federal holiday. Intermediate Saturdays, Sundays, and Federal holidays shall be excluded from the computation when the period prescribed is ten days or less.

#### **1013. New Member Application [and Membership] and Interview**

##### **(a) Filing of Application**

###### **(1) Where To File**

[Each Applicant for Association membership shall file its application in two parts. The first part of the application shall be filed with the Membership Department and shall include the following documents:]

An Applicant for Association membership shall file its application with the Department of Member Regulation at the district office in the district in which the Applicant intends to have its principal place of business as defined in Rule 1011(l).

###### **(2) Contents**

The application shall include:

(A) an original signed and notarized paper Form BD, with applicable schedules;

(B) an original signed paper Form U-4 for each Associated Person who is required to be registered under the Rules of the Association;

(C) an original NASD-approved fingerprint card for each Associated Person who will be subject to SEC Rule 17f-2;

(D) a new member assessment report;

[(E)] (E) a new member firm contact questionnaire; and]

[(F)] (E) a check for the appropriate fee[.];

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[(2) The second part of the application shall be filed with the Department of Member Regulation at the district office in the district in which the Applicant intends to have its principal place of business and shall include the following information and documents:]

[(A)] (F) a detailed business plan[, in a form prescribed by the Association,] that adequately and comprehensively describes all material aspects of the business that will be, or are reasonably anticipated to be, performed at and after the initiation of business operations, including future business expansion plans, if any, and includes:

(i) a trial balance, balance sheet, supporting schedules, and computation of net capital, each of which has been prepared as of a date that is within 30 days before the filing date of the application;

(ii) a monthly projection of income and expenses, with a supporting rationale, for the first twelve months of operations;

(iii) an organizational chart;

(iv) [a list of] the intended [locations] location of [all offices, ] the Applicant's principal place of business and all other offices, if any, whether or not such offices would be required to be registered under the Rules of the Association, and the names of the persons who will be in charge of each office;

(v) a list of the types of securities to be offered and sold and the types of retail or insti-

tutional customers to be solicited;

(vi) a description of the methods and media to be employed to develop a customer base and to offer and sell products and services to customers, including the use of the Internet, telephone solicitations, seminars, or mailings;

(vii) a description of the business facilities and a copy of any proposed or final lease;

(viii) the number of markets to be made, if any, the type and volatility of the products, and the anticipated maximum inventory positions;

(ix) any plan to enter into contractual commitments, such as underwritings or other securities-related activities;

(x) any plan to distribute or maintain securities products in proprietary positions, and the risks, volatility, degree of liquidity, and speculative nature of the products; [and]

(xi) any other activity that the Applicant may engage in that reasonably could have a material impact on net capital within the first twelve months of business operations; and

(xii) a description of the communications and operational systems the Applicant will employ to conduct business with customers or other members and the plans and procedures the Applicant will employ to ensure business continuity, including: system capacity to handle the anticipated level of usage; contin-

gency plans in the event of systems or other technological or communications problems or failures that may impede customer usage or firm order entry or execution; system redundancies; disaster recovery plans; system security; disclosures to be made to potential and existing customers who may use such systems; and supervisory or customer protection measures that may apply to customer use of, or access to, such systems;

[(B) a copy of the Applicant's most recent Form BD;]

[(C)](G) a copy of any decision or order by a federal or state authority or self-regulatory organization taking permanent or temporary adverse action with respect to a registration or licensing determination regarding the Applicant or an Associated Person;

[(D)](H) a list of all Associated Persons[, the most recent Form U-4 and Form U-5 for each Associated Person, any other document that discloses the disciplinary history of each Associated Person, and a list of any other persons or entities that will exercise control with respect to the Applicant's business];

[(E)](I) documentation of any of the following events, unless the event has been reported to the Central Registration Depository:

(i) a regulatory action against or investigation of the Applicant or an Associated Person by the Commission, the Commodity Futures Trading Commission, a federal, state, or

foreign regulatory agency, or a self-regulatory organization that is pending, adjudicated, or settled;

(ii) an investment-related civil action for damages or an injunction against the Applicant or an Associated Person that is pending, adjudicated, or settled;

(iii) an investment-related customer complaint or arbitration [involving sales practice violations, theft, misappropriation, conversion, or breach of fiduciary duty, against the Applicant or an Associated Person that is pending, settled, or has resulted in an award or judgement] that is required to be reported on Form U-4; [and]

(iv) a criminal action (other than a minor traffic violation) against the Applicant or an Associated Person that is pending, adjudicated, or that has resulted in a guilty or no contest plea; and

[(F)](v) a copy of any document evidencing a termination for cause or a permitted resignation after investigation of an alleged violation of a federal or state securities law, a rule or regulation thereunder, a self-regulatory organization rule, or an industry standard of conduct;

[(G)](j) a description of any remedial action, such as special training [or], continuing education requirements, or heightened supervision, imposed on an Associated Person by a state or federal authority or self-regulatory organization;

[(H)](k) a written acknowledgment that heightened supervisory procedures and special educational programs may be required pursuant to Notice to Members 97-19 for an Associated Person whose record[s] reflects[]:

(i) disciplinary actions [involving] or sales practice [violations] events;

(ii) customer complaints; or

(iii) arbitrations that were resolved adversely to the Associated Person;]

[(I)](L) a copy of final or proposed contracts with banks, clearing entities, or service bureaus, and a general description of any other final or proposed contracts;

[(J)](M) a description of the nature and source of Applicant's capital with supporting documentation, including a list of all persons or entities that have contributed or plan to contribute financing to the Applicant's business, the terms and conditions of such financing arrangements, the risk to net capital presented by the Applicant's proposed business activities, and any arrangement for additional capital should a business need arise;

[(K)](N) a description of the financial controls to be employed by the Applicant;

[(L)](O) a description of the Applicant's supervisory system and a copy of its written supervisory procedures, internal operating procedures (including operational and internal controls), internal inspections plan, written approval process, and

qualifications investigations required by Rule 3010;

[(M)](P) a description of the number, experience, and qualifications of supervisors and principals and the number, experience, and qualifications of persons to be supervised by such personnel, the other responsibilities of the supervisors and principals with the Applicant, their full-time or part-time status, any business activities that the supervisors or principals may engage in outside of their association with the Applicant, the hours per week devoted to such activities, and an explanation of how a part-time supervisor or principal will be able to discharge his or her designated functions on a part-time basis;

[(N)](Q) a description of Applicant's proposed recordkeeping system;

[(O)](R) a copy of the Applicant's written training plan to comply with Firm Element continuing education requirements described in Rule 1120(b), including the name of the Associated Person responsible for implementation; and

[(P)](S) [a copy of the documents described in paragraph (a)(1)] a Web CRD entitlement request form and a Member Contact Questionnaire user access request form.

**(3) Electronic Filings** [The Applicant shall file both parts of the application simultaneously by commercial courier. The application shall be deemed received on the date specified in the written confirmation of receipt generated by the commercial courier for the delivery of the second part of the

application to the district office.] Upon approval of the Applicant's Web CRD entitlement request form, the Applicant shall submit any amendments to its Forms BD or U-4, any additional Forms U-4, and any Form U-5 electronically via Web CRD. Upon approval of the Applicant's membership, the Applicant shall submit any amendments to its Member Contact Questionnaire electronically.

#### **(4) Rejection Of Application That Is Not Substantially Complete**

If the Department determines within 30 days after the filing of an application that the application is not substantially complete, the Department may reject the application and deem it not to have been filed. In such case, within the 30 day period, the Department shall serve a written notice on the Applicant of the Department's determination and the reasons therefor. The Association shall refund the application fee, less \$350, which shall be retained by the Association as a processing fee. If the Applicant determines to continue to seek membership, the Applicant shall submit a new application and fee under this Rule.

#### **(5) Request For Additional Documents Or Information**

Within 30 days after the [receipt] filing of an application, the Department shall [determine whether the application is complete and, if not, shall request] serve an initial request for any additional information or documents necessary to render a decision on the application. The Department may [request] serve subsequent requests for additional information or documents

at any time during the membership application process.

[(5)] Unless otherwise agreed by the Department and the Applicant, the Applicant shall file any additional information and documents with the Department within 60 days after service of the Department's initial request and 30 days after service of any subsequent request.

#### **[(b) Lapse of Application]**

[(1)] Absent a showing of good cause, an application for membership shall lapse if an Applicant fails to:

(A) respond fully within 60 days after an initial request for information or documents, within 30 after any subsequent request, or within such other time period agreed to by the Department and the Applicant;

(B) appear at or otherwise participate in a scheduled membership interview pursuant to paragraph (c); or

(C) return an executed membership agreement under Rule 1014(c) within 25 days after service of the agreement.]

[(2)] The lapse of an application shall require an Applicant continuing to seek membership to submit a new application under paragraph (a).]

#### **[(c)](b) Membership Interview**

##### **(1) Requirement for Interview**

Before the Department [issues a] serves its decision on an application for new membership in the Association, the Department shall conduct a membership interview with a representative or representatives of the Applicant.

##### **(2) Service of Notice**

At least seven days before the membership interview, the Department shall serve on the Applicant a written notice that specifies the date and time of the interview and the representative or representatives of the Applicant who are required to participate in the interview. The Department shall serve the notice by facsimile or [commercial] overnight courier. The Applicant and the Department may agree to a shorter or longer period for notice or a different method of service under this subparagraph.

##### **(3) Time**

Unless the Department directs otherwise for good cause shown, a membership interview shall be scheduled to occur within 90 days after the [receipt] filing of an application or within 60 days after the [receipt] filing of all additional information or documents requested, whichever is later.

##### **(4) Place**

Unless the Department and the Applicant otherwise agree, the membership interview shall be conducted in the district office for the district in which the Applicant has or intends to have its principal place of business.

##### **(5) Updated Financial Documents**

On or before the date of the membership interview, the Applicant shall file an updated trial balance, balance sheet, supporting schedules, and computation of net capital. The Applicant shall prepare such documents as of a date that is within 45 days before the date of the membership inter-



view, unless the Applicant and the Department agree on a longer period. The Applicant shall promptly notify the Department in writing of any material adverse change in its financial condition that occurs before a decision constituting final action of the Association is served on the Applicant.

#### **[(5)](6) Review of Standards for Admission**

During the membership interview, the Department shall review the application and the standards for admission to membership with the Applicant's representative or representatives.

#### **[(6)](7) Information From Other Sources**

During the membership interview, the Department shall provide to the Applicant's representative or representatives any information or document that the Department has obtained from the Central Registration Depository or a source other than the Applicant and upon which the Department intends to base its decision under Rule 1014. If the Department receives such information or document after the membership interview or decides to base its decision on such information after the membership interview, the Department shall promptly serve the information or document and an explanation thereof on the Applicant.

### **1014. Department Decision**

#### **(a) Standards for Admission**

After considering the application, the membership interview, other information and documents provided by the Applicant, other informa-

tion and documents obtained by the Department, and the public interest and the protection of investors, the Department shall determine whether the Applicant meets each of the following standards:

(1) The application and all supporting documents are complete and accurate.

(2) The Applicant and its Associated Persons have all licenses and registrations required by state and federal authorities and self-regulatory organizations.

(3) The Applicant and its Associated Persons are capable of complying with the federal securities laws, the rules and regulations thereunder, and the Rules of the Association, including observing high standards of commercial honor and just and equitable principles of trade. In determining whether this standard is met, the Department may take into consideration whether:

(A) a state or federal authority or self-regulatory organization has taken permanent or temporary adverse action with respect to a registration or licensing determination regarding the Applicant or an Associated Person;

(B) an Applicant's or Associated Person's record[s] reflects: (i) disciplinary actions involving sales practice violations; (ii) customer complaints; or (iii) arbitrations that were resolved adversely to the Applicant or Associated Person] a sales practice event;

(C) an Applicant or Associated Person is the subject of a pending, adjudicated, or settled regulatory action or investigation by the Commission, the Com-

modity Futures Trading Commission, a federal, state, or foreign regulatory agency, or a self-regulatory organization; a pending, adjudicated, or settled investment-related civil action for damages or an injunction; [an investment-related customer complaint or arbitration alleging sales practice violations, theft, misappropriation, conversion, or breach of fiduciary duty that is pending, settled, or has resulted in an award or judgment;] or a criminal action (other than a minor traffic violation) that is pending, adjudicated, or that has resulted in a guilty or no contest plea;

(D) an Associated Person was terminated for cause or permitted to resign after an investigation of an alleged violation of a federal or state securities law, a rule or regulation thereunder, a self-regulatory organization rule, or industry standard of conduct;

(E) a state or federal authority or self-regulatory organization has imposed a remedial action, such as special training [or], continuing education requirements, or heightened supervision, on an Associated Person; and

(F) a state or federal authority or self-regulatory organization has provided information indicating that the Applicant or an Associated Person otherwise poses a threat to public investors.

(4) The Applicant has established all contractual or other arrangements and business relationships with banks, clearing corporations, service bureaus, or others necessary to: (A) initiate

the operations described in the Applicant's business plan, considering the nature and scope of operations and the number of personnel; and (B) comply with the federal securities laws, the rules and regulations thereunder, and the Rules of the Association.

(5) The Applicant has or has adequate plans to obtain facilities that are sufficient to: (A) initiate the operations described in the Applicant's business plan, considering the nature and scope of operations and the number of personnel; and (B) comply with the federal securities laws, the rules and regulations thereunder, and the Rules of the Association.

(6) The communications and operational systems that the Applicant intends to employ for the purpose of conducting business with customers and other members are adequate and provide reasonably for business continuity in each area set forth in Rule 1013(a)(2)(F)(xii);

[(6)](7) The Applicant is capable of maintaining a level of net capital in excess of the minimum net capital requirements set forth in SEC Rule 15c3-1 adequate to support the Applicant's intended business operations on a continuing basis, based on information [that is current within 30 days before the membership interview] filed under Rule 1013(b)(5). The Department may impose a reasonably determined higher net capital requirement for the initiation of operations after considering:

(A) the amount of net capital sufficient to avoid early warning level reporting requirements, such as SEC Rule 17a-11;

(B) the amount of capital necessary to meet expenses net of revenues for at least twelve months, based on reliable projections agreed to by the Applicant and the Department;

(C) any planned market making activities, the number of markets to be made, the type and volatility of products, and the anticipated maximum inventory positions;

(D) any plan to enter into other contractual commitments, such as underwritings or other securities-related activities;

(E) any plan to distribute or maintain securities products in proprietary positions, and the risks, volatility, degree of liquidity, and speculative nature of the products; and

(F) any other activity that the Applicant will engage in that reasonably could have a material impact on net capital within the first twelve months of business operations.

[(7)](8) The Applicant has financial controls to ensure compliance with the federal securities laws, the rules and regulations thereunder, and the Rules of the Association.

[(8)](9) The Applicant has compliance, supervisory, operational, and internal control practices and standards that are consistent with practices and standards regularly employed in the investment banking or securities business, taking into account the nature and scope of Applicant's proposed business.

[(9)](10) The Applicant has a supervisory system, including written supervisory procedures,

internal operating procedures (including operational and internal controls), and compliance procedures designed to prevent and detect, to the extent practicable, violations of the federal securities laws, the rules and regulations thereunder, and the Rules of the Association. In evaluating the adequacy of a supervisory system, the Department shall consider the overall nature and scope of the Applicant's intended business operations and shall consider whether:

(A) 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; the [disciplinary history of such] Central Registration Depository record or other disciplinary history of supervisory personnel and persons to be supervised; [any criminal, civil, administrative, or arbitration actions or written customer complaints against such persons;] 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;

(B) the Applicant has identified specific Associated Persons to supervise and discharge each of the functions in Applicant's business plan, and to supervise each of the Applicant's intended offices, whether or not such offices are required to be registered under the Rules of the Association;

(C) the Applicant has identified the functions to be performed by each Associated Person and has adopted procedures to assure the registration with the

Association and applicable states of all persons whose functions are subject to such registration requirements.

[(C)] (D) each Associated Person identified in the business plan to discharge a supervisory function [in the business plan] has at least one year of direct experience or two years of related experience in the subject area to be supervised;

[(D)] (E) the Applicant will solicit retail or institutional business;

[(E)] (F) the Applicant will recommend securities to customers;

[(F)] (G) the location or part-time status of a supervisor or principal will affect such person's ability to be an effective supervisor;

[(G)] (H) [the records of an Associated Person reflect: (i) disciplinary actions involving sales practice violations; (ii) customer complaints; or (iii) arbitrations that were resolved adversely to the Associated Person] the Applicant should be required to place one or more Associated Persons under heightened supervision pursuant to Notice to Members 97-19;

[(H)] (I) any remedial action, such as special training or continuing education requirements or heightened supervision, has been imposed on an Associated Person by a state or federal authority or self-regulatory organization; and

[(I)] (J) 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 the Rules of the Association.

[(10)](11) The Applicant has a recordkeeping system that enables Applicant to comply with federal, state, and self-regulatory organization recordkeeping requirements and a staff that is sufficient in qualifications and number to prepare and preserve required records.

[(11)](12) The Applicant has completed a training needs assessment and has a written training plan that complies with the continuing education requirements imposed by the federal securities laws, the rules and regulations thereunder, and the Rules of the Association.

[(12)](13) The Association does not possess any information indicating that the Applicant may circumvent, evade, or otherwise avoid compliance with the federal securities laws, the rules and regulations thereunder, or the Rules of the Association.

[(13)](14) The application and all supporting documents otherwise are consistent with the federal securities laws, the rules and regulations thereunder, and the Rules of the Association.

#### **(b) Granting or Denying Application**

(1) If the Department determines that the Applicant meets each of the standards in paragraph (a), the Department shall grant the application for membership.

(2) If the Department determines that the Applicant does not meet

one or more of the standards in paragraph (a) in whole or in part, the Department [may] shall:

(A) grant the application subject to one or more restrictions reasonably designed to address a specific financial, operational, supervisory, disciplinary, investor protection, or other regulatory concern based on the standards for admission in Rule 1014(a); or

(B) deny the application.

#### **[(c) Submission of Membership Agreement**

If the Department grants an application, with or without restriction, the Applicant's approval for membership shall be contingent upon the Applicant's submission of a written membership agreement, satisfactory to the Department, undertaking to:

(1) engage only in the business set forth in the business plan and the membership agreement;

(2) abide by any restriction specified in the Department's decision;

(3) obtain the Department's prior approval of the removal or modification of such a restriction pursuant to Rule 1017; and

(4) notify and obtain the Department's approval of a change in ownership or control or a material change in business operations pursuant to Rule 1018.

The Applicant shall not waive the right to file a written request for review under Rule 1015 by executing a membership agreement under this paragraph.]

**[(d)](c) Decision****(1) Time**

The Department shall [issue] serve a written decision on the membership application within 30 days after the conclusion of the membership interview or after the [submission] filing of additional information or documents, whichever is later.

**(2) Content**

If the Department denies the application, the decision shall explain in detail the reason for denial, referencing the applicable standard or standards in paragraph (a). If the Department grants the application subject to restrictions, the decision shall explain in detail the reason for each restriction, referencing the applicable standard or standards in paragraph (a) upon which the restriction is based and identify the specific financial, operational, supervisory, disciplinary, investor protection, or other regulatory concern that the restriction is designed to address and the manner in which the restriction is reasonably designed to address the concern.

**(3) Failure to [Issue] Serve Decision**

If the Department fails to [issue] serve a decision within 180 days after [receipt] the filing of an application or such later date as the Department and the Applicant have agreed in writing, the Applicant may file a written request with the NASD Board requesting that the NASD Board direct the Department to [issue] serve a decision. Within seven days after [receipt] the filing of such a request, the NASD Board shall direct the Department to serve its

written decision immediately or to show good cause for an extension of time. If the Department shows good cause for an extension of time, the NASD Board may extend the 180 day time limit by not more than 90 days.

**(d) Submission of Membership Agreement**

If the Department grants an application, with or without restriction, the Applicant's approval for membership shall be contingent upon the Applicant's filing of an executed written membership agreement, satisfactory to the Department, undertaking to:

(1) abide by any restriction specified in the Department's decision; and

(2) obtain the Department's approval of a change in ownership, control, or business operations pursuant to Rule 1017, including the modification or removal of a membership agreement restriction.

The Applicant shall not waive the right to file a written request for review under Rule 1015 by executing a membership agreement under this paragraph.

**(e) Service and Effectiveness of Decision**

The Department shall serve its decision and the membership agreement on the Applicant in accordance with Rule 1012. The decision shall become effective upon service and shall remain in effect during the pendency of any review until a decision constituting final action of the Association is issued under Rule 1015 or 1016, unless otherwise directed by the National Adjudicatory Council, the NASD Board, or the Commission.

**(f) Effectiveness of Restriction**

A restriction imposed under this Rule shall remain in effect and bind the Applicant and all successors to the ownership or control of the Applicant unless:

(1) removed or modified by [the Department under Rule 1017] a decision constituting final action of the Association issued under Rule 1015, 1016, or 1017;

[(2) removed or modified by a decision constituting final action of the Association issued under Rule 1015 or 1016;] or

[(3)](2) stayed by the National Adjudicatory Council, the NASD Board, or the Commission.

**(g) Final Action**

Unless the Applicant files a written request for a review under Rule 1015, the Department's decision shall constitute final action by the Association.

**1015. Review by National Adjudicatory Council****(a) Initiation of Review by Applicant****[(1) Request by Applicant]**

Within 25 days after service of a decision under Rule 1014[,] or 1017 [or 1018], an Applicant may file a written request for review with the National Adjudicatory Council. A request for review shall state with specificity why the Applicant believes that the Department's decision is inconsistent with the membership standards set forth in Rule 1014, or otherwise should be set aside, and state whether a hearing is requested. The Applicant simultaneously shall [send] file by first-

class mail a copy of the request to the district office where the Applicant filed its [membership] application.

### **[(2) Notice by National Adjudicatory Council**

A decision issued under Rule 1014, 1017, or 1018 shall be subject to a call for review by any member of the National Adjudicatory Council or the Review Subcommittee defined in Rule 9120 within 30 days after service of the decision. If the National Adjudicatory Council calls a decision for review, a written notice of review shall be served promptly on the Applicant by first-class mail. The written notice of review shall state the specific grounds for the review and whether a hearing is directed. If a decision is called for review by any member of the National Adjudicatory Council or the Review Subcommittee, the decision shall be reviewed by the National Adjudicatory Council. The National Adjudicatory Council simultaneously shall send by first-class mail a copy of the notice to the district office where the Applicant filed its membership application.]

### **(b) Transmission of Documents**

Within ten days after [receipt] the filing of a request for [or notice of] review, the Department shall:

- (1) transmit to the National Adjudicatory Council copies of all documents that were considered in connection with the Department's decision and an index to the documents; and
- (2) serve on the Applicant a copy of such documents (other than those documents originally submitted by Applicant) and a copy of the index.

### **(c) Membership Application Docket**

The Department shall promptly record in the Association's membership application docket each request for [or notice of] review filed with the National Adjudicatory Council under this Rule and each material subsequent event, filing, and change in the status of a membership proceeding.

### **(d) Appointment of Subcommittee**

The National Adjudicatory Council or the Review Subcommittee defined in Rule 9120 shall appoint a Subcommittee to participate in the review. The Subcommittee shall be composed of at least two members. One member shall be a current member of the National Adjudicatory Council. The remaining member or members shall be current or past Directors or past Governors.

### **(e) Powers of Subcommittee**

If a hearing is requested [or directed], the Subcommittee shall conduct the hearing. If a hearing is not requested, the Subcommittee may serve a notice directing that a hearing be held. If a hearing is not requested or directed, the Subcommittee shall conduct its review on the basis of the record developed before the Department and any written submissions made by the Applicant or the Department in connection with the request for review.

### **(f) Hearing**

#### **(1) Notice**

If a hearing is requested or directed, the hearing shall be held within 45 days after the [receipt] filing of the request [or service of the notice by] with the National Adjudicatory Council or

service of the notice by the Subcommittee. The National Adjudicatory Council shall [send] serve written notice of the date and time of the hearing to the Applicant by facsimile or [commercial] overnight courier not later than 14 days before the hearing.

### **(2) Counsel**

The Applicant and the Department may be represented by counsel at a hearing conducted pursuant to this Rule.

### **(3) Evidence**

Formal rules of evidence shall not apply to a hearing under this Rule. Not later than five days before the hearing, the Applicant and the Department shall exchange copies of their proposed hearing exhibits and witness lists and provide copies of the same to the National Adjudicatory Council. If the Applicant or the Department fails to provide copies of its proposed hearing exhibits or witness list within such time, the Subcommittee shall exclude the evidence or witnesses from the proceeding, unless the Subcommittee determines that good cause is shown for failure to comply with the production date set forth in this subparagraph.

### **(4) Transcript**

The hearing shall be recorded and a transcript prepared by a court reporter. A transcript of the hearing shall be available for purchase from the court reporter at prescribed rates. The Applicant, the Department, or a witness may seek to correct the transcript. A proposed correction of the transcript shall be submitted to the Subcommittee within a reasonable period of time pre-

scribed by the Subcommittee. Upon notice to the Applicant and the Department, the Subcommittee may direct the correction to the transcript as requested or sua sponte.

#### **[(5) Failure to Appear at Hearing]**

[If an Applicant fails to appear at a hearing for which it has notice, the National Adjudicatory Council may dismiss the request for review as abandoned, and the decision of the Department shall become the final action of the Association. Upon a showing of good cause, the National Adjudicatory Council may withdraw a dismissal entered pursuant to this subparagraph.]

#### **(g) Additional Information, Briefs**

At any time during its consideration, the Subcommittee or the National Adjudicatory Council may direct the Applicant or the Department to [submit] file additional information [and to file] or briefs. Any additional information or brief [submitted] filed shall be provided to all parties before the National Adjudicatory Council renders its decision.

#### **(h) Abandonment of Request for Review**

If an Applicant fails to specify the grounds for its request for review under Rule 1015(a)(1), appear at a hearing for which it has notice, or file information or briefs as directed, the National Adjudicatory Council or the Review Subcommittee may dismiss the request for review as abandoned, and the decision of the Department shall become the final action of the Association. Upon a showing of good cause, the National Adjudicatory Council or the Review Subcommittee may withdraw a dismissal entered pursuant

to this paragraph.

#### **[(h)](i) Subcommittee Recommendation**

The Subcommittee shall present a recommended decision in writing to the National Adjudicatory Council within 60 days after the date of the hearing held pursuant to paragraph (f), and not later than seven days before the meeting of the National Adjudicatory Council at which the membership proceeding shall be considered.

#### **[(i)](j) Decision**

##### **(1) Proposed Written Decision**

After considering all matters presented in the review and the Subcommittee's recommended written decision, the National Adjudicatory Council may affirm, modify, or reverse the Department's decision or remand the membership proceeding with instructions. The National Adjudicatory Council shall prepare a proposed written decision pursuant to subparagraph (2).

##### **(2) Contents**

The decision shall include:

- (A) a description of the Department's decision, including its rationale;
- (B) a description of the principal issues raised in the review;
- (C) a summary of the evidence on each issue; and
- (D) a statement whether the Department's decision is affirmed, modified, or reversed, and a rationale therefor that references the applicable standards in Rule 1014.

##### **(3) Issuance of Decision After Expiration of Call for Review Periods**

The National Adjudicatory Council shall provide its proposed written decision to the NASD Board. The NASD Board may call the membership proceeding for review pursuant to Rule 1016. If the NASD Board does not call the membership proceeding for review, the proposed written decision of the National Adjudicatory Council shall become final. The National Adjudicatory Council shall serve the Applicant with a written notice specifying the date on which the call for review period expired and stating that the final written decision will be served within 15 days after such date. The National Adjudicatory Council shall serve its final written decision within 15 days after the date on which the call for review period expired. The decision shall constitute the final action of the Association for purposes of SEC Rule 19d-3, unless the National Adjudicatory Council remands the membership proceeding.

##### **(4) Failure to Issue Decision**

If the National Adjudicatory Council fails to serve its final written decision within the time prescribed in subparagraph (3), the Applicant may file a written request with the NASD Board requesting that the NASD Board direct the National Adjudicatory Council to serve its decision immediately or to show good cause for an extension of time. Within seven days after [receipt] the filing of such a request, the NASD Board shall direct the National Adjudicatory Council to serve its written decision immediately or to show good cause for an extension of time. If the

National Adjudicatory Council shows good cause for an extension of time, the NASD Board may extend the 15 day time limit by not more than 15 days.

### **1016. Discretionary Review by NASD Board**

#### **(a) Call for Review by Governor**

A Governor may call a membership proceeding for review by the NASD Board if the call for review is made within the period prescribed in [sub]paragraph [(2)] (b).

#### **(b) 15 Day Period; Waiver**

A Governor shall make his or her call for review at the next meeting of the NASD Board that is at least 15 days after the date on which the NASD Board receives the proposed written decision of the National Adjudicatory Council. By unanimous vote of the NASD Board, the NASD Board may shorten the period to less than 15 days. By an affirmative vote of the majority of the NASD Board then in office, the NASD Board may, during the 15 day period, vote to extend the period to more than 15 days.

#### **(c) Review At Next Meeting**

If a Governor calls a membership proceeding for review within the time prescribed in paragraph (b), the NASD Board shall review the membership proceeding not later than the next meeting of the NASD Board. The NASD Board may order the Applicant and the Department to file briefs in connection with review proceedings pursuant to this paragraph.

#### **(d) Decision of NASD Board, Including Remand**

After review, the NASD Board may affirm, modify, or reverse the pro-

posed written decision of the National Adjudicatory Council. Alternatively, the NASD Board may remand the membership proceeding with instructions. The NASD Board shall prepare a written decision that includes all of the elements described in Rule 1015[(i)(2)] (j)(2).

#### **(e) Issuance of Decision**

The NASD Board shall serve its written decision on the Applicant within 15 days after the meeting at which it conducted its review. The decision shall constitute the final action of the Association for purposes of SEC Rule 19d-3, unless the NASD Board remands the membership proceeding.

### **1017. [Removal or Modification of Business Restriction] Application for Approval of Change in Ownership, Control, or Business Operations**

#### **(a) Events Requiring Application**

[A member of the Association may seek modification or removal of a restriction on its business activities imposed pursuant to the Rule 1010 Series by filing a written application with the Department at the district office for the district in which the member's principal place of business is located. The application shall present facts showing that the circumstances that gave rise to the restriction have changed and state with specificity why the restriction should be modified or removed in light of the standards set forth in Rule 1014 and the articulated rationale for the imposition of the restriction. A copy of the decision and membership agreement pertaining to such restriction shall be appended to the application.]

A member shall file an application for approval of any of the following

changes to its ownership, control, or business operations:

(1) a merger of the member with another member, unless both are members of the New York Stock Exchange, Inc. or the surviving entity will continue to be a member of the New York Stock Exchange, Inc.;

(2) a direct or indirect acquisition by the member of another member, unless the acquiring member is a member of the New York Stock Exchange, Inc.;

(3) a direct or indirect acquisition of substantially all of the member's assets, unless the acquirer is a member of the New York Stock Exchange, Inc.;

(4) a change in the equity ownership or partnership capital of the member that results in one person or entity directly or indirectly owning or controlling 25 percent or more of the equity or partnership capital; or

(5) a material change in business operations as defined in Rule 1011(i).

#### **(b) Filing and Content of Application**

(1) The member shall file the application with the Department at the district office in the district in which the member's principal place of business is located. If the application involves a merger between members with principal places of business in two or more districts, the application shall be filed and processed by the district office wherein the surviving firm's principal place of business will be located.

(2) The application shall describe in detail the change in owner-

ship, control, or business operations and include a business plan, pro forma financials, an organizational chart, and written supervisory procedures reflecting the change.

(A) If the application requests approval of a change in ownership or control, the application also shall include the names of the new owners, their percentage of ownership, and the sources of their funding for the purchase and recapitalization of the member.

(B) If the application requests the removal or modification of a membership agreement restriction, the application also shall:

(i) present facts showing that the circumstances that gave rise to the restriction have changed; and

(ii) state with specificity why the restriction should be modified or removed in light of the standards set forth in Rule 1014 and the articulated rationale for the imposition of the restriction.

(C) If the application requests approval of an increase in Associated Persons involved in sales, offices, or markets made, the application shall set forth the increases in such areas during the preceding 12 months.

### **(c) Effecting Change and Imposition of Interim Restrictions**

(1) A member shall file an application for approval of a change in ownership or control at least 30 days prior to such change. A member may effect a change in ownership or control prior to the conclusion of the proceeding, but

the Department may place new interim restrictions on the member based on the standards in Rule 1014, pending final Department action.

(2) A member may file an application to remove or modify a membership agreement restriction at any time. An existing restriction shall remain in effect during the pendency of the proceeding.

(3) A member may file an application for approval of a material change in business operations, other than the modification or removal of a restriction, at any time, but the member may not effect such change until the conclusion of the proceeding, unless the Department and the member otherwise agree.

### **(d) Rejection Of Application That Is Not Substantially Complete**

If the Department determines within 30 days after the filing of an application that the application is not substantially complete, the Department may reject the application and deem it not to have been filed. In such case, within the 30 day period, the Department shall serve a written notice on the Applicant of the Department's determination and the reasons therefor. If the Applicant determines to continue to apply for approval of a change in ownership, control, or business operations, the Applicant shall submit a new application under this Rule.

### **[(b)](e) Request for Additional Documents and Information**

Within 30 days after the [receipt] filing of an application [to remove or modify a restriction], the Department shall [determine whether the application is complete, and if not, shall] serve a request for any addi-

tional information or documents necessary to render a decision [under paragraph (e)] on the application. The Department may serve subsequent requests for additional information or documents at any time during the application process. Unless otherwise agreed by the Department and the Applicant, the Applicant shall file any additional information and documents with the Department within 30 days after service of a request.

### **[(c) Lapse]**

[(1) Absent a showing of good cause, an application to modify or remove a restriction shall lapse if an Applicant fails to:

(A) respond fully within 30 days after a request for information or documents;

(B) appear at or otherwise participate in a scheduled membership interview pursuant to paragraph (d); or

(C) return an executed membership agreement under paragraph (e)(4) within 25 days after service of the agreement.

(2) The lapse of an application shall require the Applicant to submit a new application to modify or remove a restriction under paragraph (a).]

### **[(d)](f) Membership Interview**

(1) The Department may require the Applicant to participate in a membership interview within 30 days after the [receipt] filing of the application, or if the Department requests additional information or documents, within 30 days after the filing of the additional information or documents by the Applicant.



(2) At least seven days before the membership interview, the Department shall serve on the Applicant a written notice that specifies the date and time of the interview and [the representative or representatives of the Applicant] persons who are required to participate in the interview. The Department shall serve the notice by facsimile or [commercial] overnight courier. The Applicant and the Department may agree to a shorter or longer period for notice or a different method of service.

(3) Unless the Department and the Applicant otherwise agree, the membership interview shall be conducted in the district office for the district in which the Applicant has its principal place of business.

(4) During the membership interview, the Department shall review the application and the considerations for the Department's decision set forth in paragraph [(e)(1)] (g)(1). The Department shall provide to the Applicant's representative or representatives any information or document that the Department has obtained from the Central Registration Depository or a source other than the Applicant and upon which the Department intends to base its decision under paragraph [(e)(1)](g). If the Department receives such information or document after the membership interview or decides to base its decision on such information after the membership interview, the Department shall promptly serve the information or document and an explanation thereof on the Applicant.

#### **[(e)](g) Department Decision**

(1) [In evaluating an application submitted under paragraph (a)] The Department shall consider the application, the membership interview, other information and documents provided by the Applicant or obtained by the Department, the public interest, and the protection of investors.

(A) In rendering a decision on an application for approval of a change in ownership or control, or an application for approval of a material change in business operations that does not involve modification or removal of a membership agreement restriction, the Department shall determine if the Applicant would continue to meet the standards in Rule 1014(a) upon approval of the application.

(B) In rendering a decision on an application requesting the modification or removal of a membership agreement restriction, the Department shall consider whether maintenance of the restriction is appropriate in light of:

[(A)](i) the standards set forth in Rule 1014;

[(B)](ii) the circumstances that gave rise to the imposition of the restriction;

[(C)](iii) the Applicant's operations since the restriction was imposed;\_

[(D)] (iv) [a] any change in ownership or control or supervisors and principals; and

[(E)](v) any new evidence submitted in connection with the application.

(2) The Department shall [issue] serve a written decision on the application within 30 days after the conclusion of the membership interview or the [submission] filing of additional information or documents, whichever is later. If the Department does not require the Applicant to participate in a membership interview or request additional information or documents, the Department shall [issue] serve a written decision within 45 days after the [receipt] filing of the application under paragraph (a). The decision shall state whether the application [to modify or remove the restriction] is granted or denied in whole or in part, and shall provide a rationale for the Department's decision, referencing the applicable standard in Rule 1014.

(3) If the Department fails to [issue] serve a decision within 180 days after [receipt] filing of an application or such later date as the Department and the Applicant have agreed in writing, the Applicant may file a written request with the NASD Board requesting that the NASD Board direct the Department to issue a decision. Within seven days after [receipt] the filing of such a request, the NASD Board shall direct the Department to issue a written decision immediately or to show good cause for an extension of time. If the Department shows good cause for an extension of time, the NASD Board may extend the time limit for issuing a decision by not more than 30 days.

(4) If the Department [modifies or removes a restriction on the Applicant's business activities, the] approves an application under this Rule in whole or part, the Department shall require an Applicant to file an executed

membership agreement [submitted under Rule 1014 shall be modified accordingly].

**[(f)](h) Service and Effectiveness of Decision**

The Department shall serve its decision on the Applicant in accordance with Rule 1012. The decision shall become effective upon service and shall remain in effect during the pendency of any review until a decision constituting final action of the Association is [issued] served under Rule 1015 or 1016, unless otherwise directed by the National Adjudicatory Council, the NASD Board, or the Commission.

**[(g)](i) Request for Review; Final Action**

An Applicant may file a written request for review of the Department's decision with the National Adjudicatory Council pursuant to Rule 1015. The procedures set forth in Rule 1015 shall apply to such review, and the National Adjudicatory Council's decision shall be subject to discretionary review by the NASD Board pursuant to Rule 1016. If the Applicant does not file a request for a review, the Department's decision shall constitute final action by the Association.

**[(h)](j) Removal or Modification of Restriction on Department's Initiative**

The Department shall modify or remove a restriction on its own initiative if the Department determines such action is appropriate in light of the considerations set forth in paragraph [(e)(1)](g)(1). The Department shall notify the member in writing of the Department's determination and inform the member that it may apply for further modification or removal of a restriction by filing an application under paragraph (a).

**(k) Lapse or Denial of Application for Approval of Change in Ownership**

If an application for approval of a change in ownership lapses, or is denied and all appeals are exhausted or waived, the member shall, no more than 60 days after the lapse or exhaustion or waiver of appeal:

- (1) submit a new application;
- (2) unwind the transaction; or
- (3) file a Form BDW.

For the protection of investors, the Department may shorten the 60-day period. For good cause shown by the member, the Department may lengthen the 60-day period. The Department shall serve written notice on the Applicant of any change in the 60-day period and the reasons therefor. During the 60-day or other imposed period, the Department may continue to place interim restrictions on the member for the protection of investors.

**[1018. Change in Ownership, Control, or Operations]****[(a) Notice**

At least 30 days prior to the occurrence of any of the following changes in ownership, control, or operations, a member shall file a written notice and application for continuance in membership with the Department at the district office in the district in which the member's principal place of business is located:

- (1) a merger of the member with another member;
- (2) an acquisition by the member of another member;
- (3) an acquisition of substantially

all of the member's assets;

(4) a change in the equity ownership or partnership capital of the member that results in one person or entity owning or controlling 25 percent or more of the equity or partnership capital; or

(5) a material change in the member's business operations.]

**[(b) Review and Imposition of Interim Restrictions**

The Department shall review a change in ownership, control, or operations described in paragraph (a) prior to the change taking effect. The Department may maintain existing restrictions on the member's business activities and place new interim restrictions on the member based on the standards in Rule 1014, pending final Department action.]

**[(c) Request for Information**

Within 30 days after receipt of the notice and application under paragraph (a), the Department shall request any additional information or documents necessary to render a decision under paragraph (f). Unless otherwise agreed by the Department and the Applicant, the Applicant shall file such additional information or documents with the Department within 30 days after the Department's request. The Department may request additional information and documents at any time during the application process; unless the Applicant and the Department agree otherwise, the Applicant shall file such information or documents within 30 days after the Department's request.]

**[(d) Lapse**

(1) Absent a showing of good cause, an application for continu-

ance in membership shall lapse if an Applicant fails to:

(A) respond fully within 30 days after a request for information or documents;

(B) appear at or otherwise participate in a scheduled membership interview pursuant to paragraph (e); or

(C) return an executed membership agreement under paragraph (g) within 25 days after service of the agreement.

(2) The lapse of an application shall require the Applicant to submit a new application under paragraph (a).]

#### **[(e) Membership Interview**

(1) The Department may require the Applicant to participate in a membership interview. The membership interview shall be held within 30 days after the receipt of the application, or if the Department requests additional information or documents, within 30 days after the filing of such additional information or documents by the Applicant.

(2) At least seven days before the membership interview, the Department shall serve on the Applicant a written notice that specifies the date and time of the interview and the representative or representatives of the Applicant who are required to participate in the interview. The Department shall serve the notice by facsimile or commercial courier. The Applicant and the Department may agree to a shorter or longer period for notice or a different method of service.

(3) Unless the Department and the Applicant otherwise agree,

the membership interview shall be conducted in the district office for the district in which the Applicant has or intends to have its principal place of business.

(4) During the membership interview, the Department shall review the application and the considerations for the Department's decision set forth in paragraph (f). The Department shall provide to the Applicant's representative or representatives any information or document that the Department has obtained from the Central Registration Depository or a source other than the Applicant and upon which the Department intends to base its decision under paragraph (f). If the Department receives such information or document after the membership interview or decides to base its decision on such information after the membership interview, the Department shall promptly serve the information or document and an explanation thereof on the Applicant.]

#### **[(f) Department Decision**

(1) In evaluating an application submitted under paragraph (a), the Department shall consider whether the Applicant continues to meet the standards set forth in Rule 1014 in light of the change in ownership, control, or operations, and whether current restrictions, if any, or new restrictions are necessary for the Applicant to continue to meet such standards.

(2) The Department shall issue a written decision within 30 days after the membership interview or the submission of additional information or documents, whichever is later. If the Department does not require the Applicant to participate in a

membership interview or submit additional information or documents, the Department shall issue a written decision within 45 days after receipt of an application under paragraph (a). The decision shall state the terms for continuance in NASD membership, whether current restrictions, if any, are maintained or new restrictions are imposed, and shall provide a rationale for the Department's decision, referencing the applicable standard in Rule 1014.

(3) If the Department fails to issue a decision within 180 days after receipt of an application or such later date as the Department and the Applicant have agreed in writing, the Applicant may file a written request with the NASD Board requesting that the NASD Board direct the Department to issue a decision. Within seven days after receipt of such a request, the NASD Board shall direct the Department to issue a written decision immediately or to show good cause for an extension of time. If the Department shows good cause for an extension of time, the NASD Board may extend the time limit for issuing a decision by not more than 30 days.]

#### **[(g) Submission of Membership Agreement**

The Department may condition approval of an application for continuance in membership on the Applicant's submission of a new written membership agreement pursuant to Rule 1014(c).]

#### **[(h) Service and Effectiveness of Decision**

The Department shall serve its decision on the Applicant in accordance with Rule 1012. The decision

shall become effective upon service and shall remain in effect during the pendency of any review until a decision constituting final action of the Association is issued under Rule 1015 or 1016, unless otherwise directed by the National Adjudicatory Council, the NASD Board, or the Commission.]

**[(i) Request for Review; Final Action**

An Applicant may file a written request for review of the Department's decision with the National Adjudicatory Council pursuant to Rule 1015. The procedures set forth in Rule 1015 shall apply to such a review, and the National

Adjudicatory Council's decision shall be subject to discretionary review by the NASD Board pursuant to Rule 1016. If the Applicant does not file a request for review, the Department's action shall constitute the final action of the Association.]

**1018. Reserved**

**1019. Application to Commission for Review**

No change.

\* \* \*

**Rule 1140. Electronic Filing Rules**

(a) Filing Requirement

Except as provided in Rule 1013(a)(2), all [All] forms required to be filed by the By-Laws shall be filed through an electronic process or such other process the Association may prescribe to the Central Registration Depository.

\* \* \*

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