

BEFORE THE NATIONAL ADJUDICATORY COUNCIL  
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the

New Member Application of

Applicant Firm

DECISION

Application No.

Dated: June 2, 2021

**FINRA’s Department of Member Supervision denied firm’s application for membership. Held, denial affirmed.**

**Appearances**

For Applicant Firm: Owner and Person A

For the Department of Member Supervision: Attorney 1, Attorney 2, Attorney 3

**Decision**

Pursuant to FINRA Rule 1015(a), Applicant Firm (“Applicant Firm”) appeals a September 21, 2020 Department of Member Supervision (“Member Supervision”) decision denying the firm’s application to become a FINRA member firm. After conducting a hearing, reviewing the record, and considering the parties’ arguments, we affirm Member Supervision’s decision to deny Applicant Firm’s FINRA membership application.

I. Background and Procedural History

The FINRA Membership Rule 1010 Series sets out the substantive standards and procedural guidelines for the membership application and registration process. FINRA Rule 1013 governs the new member application process. Once a prospective firm files a substantially complete application with FINRA, Member Supervision conducts a review to determine whether FINRA requires any additional information from the applicant firm to conduct a meaningful review of the application. After receiving any additional requested information or documentation from the applicant firm, FINRA may make subsequent requests for information.

Prior to making a decision on the application, Member Supervision conducts a membership interview with the applicant firm. During the membership interview, Member Supervision reviews the application and FINRA’s standards for admission to membership with the applicant firm and its representatives.

Member Supervision then issues its decision. The decision whether to admit a firm to FINRA membership is governed by the membership standards articulated in FINRA Rule 1014. The applicant firm bears the burden of demonstrating that it meets each of the rule's standards. If the applicant firm fails to demonstrate that it satisfies each of the rule's 14 standards, the application will be denied.

A. Applicant Firm's New Member Application

Applicant Firm filed its initial New Member Application ("NMA") on November 5, 2019. Pursuant to its NMA, the firm proposed to engage in four lines of business: developing and operating an alternative trading system ("ATS");<sup>1</sup> selling private placement securities to accredited investors; engaging in proprietary trading; and acting as an underwriter or selling group participant ("investment banking activities"). The NMA stated that to launch its ATS operations, Applicant Firm would need to raise approximately \$50 million in financing. The firm stated it would not hold customer funds or securities.

The NMA stated that Applicant Firm is wholly owned by Parent Company, and that Owner is the majority owner and control person of Parent Company. Owner proposed to act as the chief executive officer ("CEO"), chief compliance officer ("CCO"), anti-money laundering compliance officer ("AMLCO"), and general securities principal responsible for the supervision of the ATS and proprietary trading activities. Applicant Firm proposed to register Person A as its financial and operations principal ("FINOP") and second general supervisory principal with responsibility for supervising the private placement of securities and investment banking activities. The firm stated it did not intend to retain any additional registered representatives and proposed to operate one office during the first 12 months of operation, which would be located on property owned by Owner. The NMA disclosed that Owner had outside business activities to which he would dedicate no more than ten hours a week: Parent Company, Company B,<sup>2</sup> and Company C.

On November 11, 2019, Member Supervision alerted Applicant Firm that there were several deficiencies in its initial NMA. Member Supervision specifically requested that Applicant Firm provide additional information about Company B, bank account information for the firm and Company B, the firm's procedures for its proposed private placement of securities business, and whether the firm's ATS was "demo-ready," such that the firm could present a functioning trading platform to Member Supervision. In response, Applicant Firm filed revised NMAs on November 18, 2019, and November 30, 2019.<sup>3</sup> Applicant Firm represented that it

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<sup>1</sup> An ATS is a non-exchange trading venue that matches buyers and sellers to find counterparties for transactions. ATSs are generally regulated as broker-dealers rather than as exchanges.

<sup>2</sup> Owner previously owned another FINRA broker-dealer, also named Applicant Firm (from August 3, 2005 through September 3, 2015), then renamed Company B (from September 3, 2015 through August 6, 2019). Company B was renamed when it was sold to a third party.

<sup>3</sup> Applicant Firm submitted nine revised NMAs over the course of the application process.

would have a “demo ready” ATS available. Member Supervision accepted the NMA as substantially complete on December 6, 2019.

B. Member Supervision’s Review of Applicant Firm’s New Member Application

1. Member Supervision’s Request for Additional Information<sup>4</sup>

After accepting Applicant Firm’s NMA as substantially complete, Member Supervision made several requests to the firm for additional information to adequately assess the firm’s ability to meet the standards for membership contained in FINRA Rule 1014.

a. First Information Request

On January 6, 2020, Member Supervision requested that Applicant Firm submit an updated NMA that addressed Member Supervision’s questions concerning the ownership and control of the firm, the proposed business activities, registration requirements, the general requirements for the operation of a broker-dealer (including clearing arrangements, fidelity bond, and the firm’s electronic storage/email archiving vendor), and clarification of the firm’s written supervisory procedures (WSPs). Applicant Firm responded on March 4, 2020. In relevant part, the firm replied that it planned to engage in private placement and investment banking activities that require Series 79 registration (investment banking representative), and that Person A would be taking the Series 79 examination. In addition, Applicant Firm responded that Owner would engage in and supervise the firm’s proposed proprietary trading and that it believed Owner would not need to pass any additional trading exams.<sup>5</sup> Finally, the firm represented that it was making arrangements to procure a clearing arrangement, a fidelity bond, and a contract for the firm’s electronic storage/email archive system.

b. Second Information Request

On April 1, 2020, after a telephone conversation with Person A, Member Supervision emailed him seeking clarification and additional information regarding Applicant Firm’s proposed membership. Specifically, Member Supervision asked for the following information:

- an explanation as to why Owner believed he did not need to take the Series 57 (securities trader representative) examination if he would be conducting and supervising proprietary trading and market making activities;
- a description of Company C’s business and any planned interaction between it and Applicant Firm, as well as payments made on behalf of Applicant Firm by Parent Company and Company C; and

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<sup>4</sup> Member Supervision’s requests and Applicant Firm’s responses that are not germane to Member Supervision’s denial or the instant appeal are not discussed in this decision.

<sup>5</sup> Owner possesses Series 24, 62, and 63 registrations.

- a resume for Person A that included his work history and educational background, as well as a narrative description of Person A's specific experience with investment banking and underwriting.

Applicant Firm responded on April 30, 2020. The firm explained that it believed Owner did not need to take the Series 57 examination because "trading/ market making activity would be for the firm's own account and shall not be carried out for customers or third parties. Such activity is not anticipated till the ATS becomes functional." It stated that, because Applicant Firm would not have any income until it started business operations, its expenses would be paid by Parent Company and Company C. In response to Member Supervision's questions concerning Company C's business, Applicant Firm responded that Company C was "a company in existence since 1997, through which [Owner] had carried out several business operations. It continues to meet several running expenses." The firm included Person A's resume and explained that Person A had 12 years of investment banking and venture capital experience, and would be taking the Series 79 exam shortly.<sup>6</sup> The firm also included updated WSPs that identified Person A as the proposed CCO, replacing Owner.

c. Third Information Request

On June 3, 2020, Member Supervision sent its third request for additional information to the firm, via an email to Person A. Member Supervision sought an update on Applicant Firm's efforts to partner with an investor in connection with the development of the proposed ATS. Member Supervision sought additional information related to the adequacy of Person A's experience to serve as the firm's CCO and a detailed description of Person A's experience specific to investment banking, underwriting, and compliance. Member Supervision again sought clarity regarding Owner's belief that he did not need a Series 57 to supervise the firm's proposed proprietary trading. Member Supervision also advised Applicant Firm that it needed to provide copies of contracts or agreements evidencing that it had secured a fidelity bond, a third-party provider of electronic storage, as well as an auditor engagement letter.

Applicant Firm responded on July 3, 2020. Applicant Firm represented that once its membership application was approved, it would attempt to secure financing from banks and other sources. In response to Member Supervision's inquiry into the adequacy of Person A's experience to serve as the firm's CCO, Applicant Firm responded:

[Person A] has worked in a bank [] for 12 years in a managerial capacity.<sup>7</sup> He has been a Principal and FINOP in the erstwhile [Applicant Firm] since 2006. Apart from filing FOCUS reports, he has been involved in all activities of the firm, including compliance with FINRA and state agencies. The Firm is of the opinion that [Person A] would be able to serve as CCO satisfactorily.

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<sup>6</sup> Person A twice took the Series 79 examination—in November 2019 and July 2020—and did not pass either time.

<sup>7</sup> Person A's resume reflects that he worked at [] from 1986 through 1999.

In response to Member Supervision's inquiry concerning Person A's experience specific to investment banking and underwriting, Applicant Firm responded:

[Person A], while working in the bank, has [sic] involved in the due diligence and preparation of prospectus for companies doing public or private placement of securities. While working in the venture capital arm of the bank, he has [sic] involved in pricing of private placements seeking additional finance by the invested companies. Erstwhile [Applicant Firm], did not have investment banking business, but [], the parent had done some private placements and Person A had taken care of the procedures to [sic] in the issue of securities and subsequent reporting to state agencies.

Applicant Firm also noted that Person A handled other compliance requirements such as computing net capital, filing FOCUS reports with FINRA, and working with FINRA during its examinations. Applicant Firm reiterated that Owner was not required to have the Series 57 because the firm would be using loaned funds from its parent company rather than its own funds. Finally, as to the requirement that it secure the necessary contracts and agreements prior to the application being submitted for approval, Applicant Firm responded that it had secured letters of intent but would not finalize the contracts until after its membership application had been approved.

d. Fourth Information Request

On July 17, 2020, Member Supervision sent Applicant Firm its final request for additional information.<sup>8</sup> Among other things, Member Supervision asked the firm to further elaborate on how Person A's compliance experience qualified him to act as the firm's CCO.

Applicant Firm responded the following day, stating that:

[Person A] has worked for [Company C] for [sic] since 1999. He has attended to administrative duties including compliance with FINRA and state security agencies since 2006. He served as a Series 24 principal and Series 27 FINOP for a FINRA BD from 2006 to 2019 that was owned by [Parent Company]. Due to the fact that the proposed firm may not have customers and trading business in the immediate future, there may not be specific day to day responsibilities for [Person A]. He will be responsible for any compliance and administrative tasks related to keeping the BD in good standing with FINRA and SEC. He will also continue as FINOP of the firm.

3. Applicant Firm's Membership Interview

On June 23, 2020, the day before the membership interview, Member Supervision emailed the firm about Member Supervision's expectations regarding Applicant Firm's demonstration of its ATS. Member Supervision asked that during the membership interview,

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<sup>8</sup> This final request was made after the June 24, 2020 membership interview.

Applicant Firm “provide a walk-through of the platform explaining the user experience and functionality, and provide a review of the system capabilities and Firm controls and oversight.” Member Supervision also asked Applicant Firm to be ready to demonstrate the “functionality and purpose of each trading system within the Applicant Firm,” onboarding of customers, a walk-through of a typical transaction, trade reporting, risk management controls, surveillance and reporting functionality, and development status. In addition, Member Supervision indicated that the membership interview would cover proposed business activities, supervision and management, funding of the firm, and expense reimbursement/sharing agreements with Company C.

On June 24, 2020, Member Supervision conducted the membership interview with Applicant Firm. At the hearing in this matter, Member Supervision described the membership interview as “chaotic.” Despite Member Supervision’s specific request, Applicant Firm did not provide a demonstration of its ATS platform for Member Supervision to review. Rather, the firm presented schematics and screenshots, i.e., not an operational system. In addition, at its membership interview and in subsequent correspondence, Applicant Firm offered to “hand over all the patents . . . and all technology already built to FINRA for a 3% royalty. . . .”

#### 4. Member Supervision’s Due Diligence

Member Supervision engaged in an independent due diligence review of Applicant Firm, Owner, and Person A to determine, among other things, whether all outside business activities had been identified and properly disclosed. During its review, Member Supervision discovered that Owner did not disclose in his NMA that he was the CEO of Company D, a cryptocurrency company that operated from the same address as Applicant Firm. Nor did Owner disclose this outside business activity on his Uniform Application for Securities Industry Registration or Transfer (“Form U4”). In December 2018, while he was still associated with his previous firm, Owner had updated his Form U4, but did not disclose his affiliation with Company D.

Company D described itself as “an ERC20 cryptocurrency based on the Ethereum blockchain,” which was “currently being sold to get the necessary funding for the creation of two exchanges, own [sic] which will be a cryptocurrency exchange and the other will be focused on financial stocks.” Furthermore, Company D stated that it planned to “fund [Parent Company] and its subsidiary [] . . . [which] will immediately launch its SEC-regulated Alternative Trading System into the market . . . .”

#### C. Member Supervision Denies Applicant Firm’s New Member Application

Member Supervision issued its decision letter on September 21, 2020, denying Applicant Firm’s application because the firm failed to satisfy the requirements of FINRA Rule 1014(a)(1), (2), (4), (10), and (13). Specifically, Member Supervision stated that it denied Applicant Firm’s application because it had found that Applicant Firm: failed to file a complete and accurate application; the firm’s principals were not properly licensed; the firm failed to establish all contractual or other arrangements necessary to operate in compliance with the federal securities laws, the rules and regulations thereunder, and FINRA rules; the firm did not have a supervisory system designed to prevent and detect violations of federal securities laws and FINRA rules; and

Member Supervision possessed information that the firm may circumvent or evade federal securities laws or FINRA rules.

1. Member Supervision's Findings Under FINRA Rule 1014(a)(1)

Member Supervision determined that Applicant Firm did not submit a complete and accurate application as required by FINRA Rule 1014(a)(1). First, Member Supervision concluded that Applicant Firm failed to set forth a feasible business model. Because of the firm's failure to provide a detailed description and demonstration of the proposed ATS, and its failure to provide any specific details regarding the financing needed to launch and operate the ATS, Member Supervision concluded the firm did not provide a sufficient picture of how it would fund and operate the ATS.

Second, Member Supervision determined that Applicant Firm's communications and representations during the application process did not instill confidence that the firm intended to conduct business as a FINRA member. Specifically, Applicant Firm gave Member Supervision conflicting information regarding whether it intends to operate as an "active" member firm or if it is seeking membership just to sell its technology or the broker-dealer. Member Supervision's decision stated that the FINRA By-Laws do not provide for dormant or inactive membership.

The final basis for Member Supervision's denial based on FINRA Rule 1014(a)(1) was the firm's failure to disclose Owner's involvement with Company D, which Applicant Firm was required to do as part of the application process. In addition, Member Supervision determined that the firm's responses with respect to Owner's involvement with Company C lacked sufficient detail for Member Supervision to ascertain what business operations are conducted by Owner through Company C.

2. Member Supervision's Findings Under FINRA Rule 1014(a)(2)

Member Supervision concluded that Applicant Firm failed to demonstrate that its supervisory principals were properly licensed. To engage in the proposed business lines, the firm would need to register an investment banking representative (Series 79) and a securities trader representative (Series 57) to supervise its investment banking and proprietary trading businesses. However, neither Person A nor Owner obtained their respective licenses.

3. Member Supervision's Findings Under FINRA Rule 1014(a)(4)

Member Supervision concluded that Applicant Firm did not establish all contractual or other arrangements and business relationships with banks, clearing corporations, service bureaus or others necessary to initiate the operations described in the firm's business plan considering the nature and scope of operations and the number of personnel and comply with the federal securities laws, the rules and regulations thereunder, and FINRA rules. Specifically, the firm was required to secure a fidelity bond, an audit engagement letter, and a contract or agreement with an electronic storage company prior to its application being approved. Applicant Firm did none of those things.

4. Member Supervision's Findings Under FINRA Rule 1014(a)(10)

Member Supervision determined that the firm and Person A failed to meet the criteria in Rule 1014(a)(10), which required the firm to have a supervisory system designed to prevent and detect, to the extent practicable, violations of the federal securities laws and FINRA rules. Applicant Firm did not provide sufficient information for Member Supervision to conclude that Person A had the requisite experience to serve as the firm's CCO or to supervise the firm's investment banking activities, as required by the rule.

5. Member Supervision's Findings Under FINRA Rule 1014(a)(13)

Member Supervision's final basis for denial arose out of its conclusion that Applicant Firm may circumvent, evade, or otherwise avoid compliance with applicable securities laws. First, Member Supervision found that the firm failed to present a feasible business model and made representations which led Member Supervision to conclude the firm may not actually intend to commence business operations. Second, the firm failed to disclose Owner's ownership and control of an outside business activity, which is contrary to the new membership application requirement. Finally, the firm failed to obtain the licenses and registrations required to engage in the proposed business operations, and Person A lacked the experience and qualifications to adequately perform his supervisory and compliance responsibilities. In sum, Member Supervision concluded that the firm's failures to comply with the membership requirements on several fronts indicated that it may circumvent, evade, or avoid compliance in the future.

D. Applicant Firm Appeals Member Supervision's Denial

Pursuant to FINRA Rule 1015(a), Applicant Firm appealed Member Supervision's decision on October 15, 2020. On appeal, Applicant Firm argues that Member Supervision's decision is untimely and inconsistent with the membership standards set forth in FINRA Rule 1014. As stated in greater detail below, Applicant Firm's appeal letter argues why each of the reasons presented by Member Supervision should be rejected.

On February 11, 2021, a Subcommittee of the National Adjudicatory Council ("NAC") presided over an evidentiary hearing at which the parties presented opening and closing statements, witness testimony, and documentary evidence.<sup>9</sup> Applicant Firm was represented at the hearing by Owner, who also testified on behalf of the firm, and Person A. Applicant Firm called three additional witnesses: FINRA Employee 1, Senior Director in the Membership Application Program; FINRA Employee 2, Principal Analyst in Risk Monitoring; and Person A. Member Supervision called three witnesses: FINRA Employee 1; FINRA Employee 3, Principal Examiner in the Membership Application Program; and FINRA Employee 4, Associate District

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<sup>9</sup> The Subcommittee hearing this appeal admitted all of Applicant Firm's and Member Supervision's proposed exhibits that were proffered for admission.



Director in the Membership Application Program. On February 28, 2021, the parties submitted their post-hearing briefs.<sup>10</sup>

### III. Discussion

FINRA Rule 1014(a) delineates the standards that an applicant firm must meet before Member Supervision may approve a request for membership admission. The standards under FINRA Rule 1014(a) are intended to ensure that members can satisfy all relevant regulatory requirements for the protection of the investing public, the securities markets, the applicant, and other member applicants. *Membership Continuance Application of Member Firm*, Application No. 20060058633, 2007 FINRA Discip. LEXIS 31, at \*44-45 (FINRA NAC July 2007). When assessing whether an applicant for membership meets these standards, FINRA Rule 1014(a) requires Member Supervision to consider, among other things, “the public interest and the protection of investors.” The applicant firm bears the burden of demonstrating that it meets each of the rule’s standards for membership approval. *New Membership Application of Firm A*, Application No. 20090182345, 2010 FINRA Discip. LEXIS 24, at \*22 (FINRA NAC Sept. 28, 2010); *see also* FINRA Rules 1014(a), (b). Member Supervision found that Applicant Firm failed to demonstrate it could meet five of the standards articulated in FINRA Rule 1014(a).

#### A. Member Supervision’s Late Issuance of the Decision

Before addressing whether the firm meets the standards for FINRA membership, we consider Applicant Firm’s argument that Member Supervision’s decision is invalid because it was issued late, in contravention of FINRA rules. Applicant Firm argues that Member Supervision “violated the law” when it issued its decision outside the 180-day window prescribed by the rules.<sup>11</sup> Member Supervision acknowledges that it issued its decision late, but

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<sup>10</sup> Pursuant to FINRA Rule 1015(g), on February 18, 2021, the Subcommittee asked Member Supervision to provide a copy of the rule, policy, or procedure that addressed Member Supervision’s requirement that any applicant seeking approval to operate an ATS must present or provide a “demo-ready” platform during the membership application process, and the year that the rule, policy, or procedure was implemented. Member Supervision included its response to this request in its post-hearing brief. It explained that its practice of requiring applicants seeking to operate an ATS to present a “demo-ready” platform is based on FINRA Rule 1014(a)(6), which requires Member Supervision to determine whether the “communications and operational systems that the Applicant intends to employ for the purpose of conducting business with customers and other members are adequate,” as well as Member Supervision’s inherent authority to investigate issues that it discovers while reviewing an application, which the NAC has recognized since at least 2006.

<sup>11</sup> Applicant Firm argues that Member Supervision’s delay in issuing its decision was criminal and violated the “34 Act.” Nevertheless, we understand the alleged violation to be of FINRA Rule 1014(c)(3). The firm further argues that the delay violated Owner’s constitutional right to due process. Putting aside that the firm had notice, production of all documents called for by Rule 1015(b), and a full evidentiary hearing, “[it] is well established that the requirements of constitutional due process do not apply to FINRA because FINRA is not a state actor.”

argues that the rules provide for relief that the firm did not seek. We agree with Member Supervision.

FINRA Rule 1014(c) contains two provisions regarding the timing of Member Supervision's decision on a membership application. First, FINRA Rule 1014(c)(1) provides that Member Supervision "shall serve a written decision on the membership application within 30 days after the conclusion of the membership interview or after the filing of additional information or documents, whichever is later." Second, FINRA Rule 1014(c)(3) provides that, if Member Supervision "fails to serve a decision within 180 days after 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 FINRA Board requesting that the FINRA Board direct the Department to serve a decision." Once such a request is filed, the FINRA Board must, within seven days, "direct [Member Supervision] to serve its written decision immediately or to show good cause for an extension of time." There is no dispute that Member Supervision did not act on Applicant Firm's application within either time period set out in FINRA Rule 1014(c).

Member Supervision did not issue its written decision within 30 days after the conclusion of the membership interview or after the filing of additional information or documents. Although Applicant Firm's membership interview occurred on June 24, 2020, Member Supervision issued its fourth and final information request on July 17, 2020. Applicant Firm responded the following day. Thus, under FINRA Rule 1014(c), Member Supervision's deadline for issuing its decision was 30 days after July 18, 2020, i.e., August 17, 2020. Member Supervision served its decision on September 21, 2020, approximately one month later.

Nor did Member Supervision issue its written decision within 180 days after Applicant Firm filed its application or "such later date" as Member Supervision and Applicant Firm had agreed in writing.<sup>12</sup> FINRA Rule 1014(c)(3) provides the remedy for this delay— if Member Supervision fails to serve a decision within 180 days after the filing of an application (or such later date as the Department and the Applicant have agreed in writing), the applicant firm may ask FINRA's Board of Governors in writing to "direct [Member Supervision] to serve a decision." If the firm files such a request, within seven days the board must direct Member Supervision to issue its decision immediately or show good cause for an extension of time. This is the only remedy an applicant firm can seek. *See Sierra Nevada Secs., Inc.*, 54 S.E.C. 112, 122 (1999) (finding that a procedural error did not deny the firm a fair hearing and that "the only remedy for delay provided by Rule 1014 is an order requiring that a decision be issued immediately").

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*Asensio & Co., Inc.*, Exchange Act Release No. 68505, 2012 SEC LEXIS 3954, at \*61 (Dec. 20, 2012).

<sup>12</sup> Applicant Firm and Member Supervision agreed to an application extension at least through July 20, 2020.

Applicant Firm did not, however, request such an order. On appeal, the firm essentially argues that its application must be granted because Member Supervision's decision was late. While we are concerned about a FINRA applicant not receiving a decision within the time allotted in FINRA Rule 1014, we will not avoid evaluating the substance of this application when neither logic nor the rules support our doing so. Applicant Firm's contention that we should grant its application because Member Supervision's decision was issued late has no merit. Member Supervision's decision is valid, despite its untimeliness.

B. Applicant Firm Does Not Satisfy FINRA's Standards for Membership

We now turn to the substance of Member Supervision's finding that Applicant Firm failed to carry its burden to demonstrate that it has satisfied the standards set forth in FINRA Rule 1014(a).

1. Applicant Firm Does Not Satisfy the Standards Set Forth in FINRA Rule 1014(a)(2)

FINRA Rule 1014(a)(2) requires applicants to have "have all licenses and registrations required by state and federal authorities and self-regulatory organizations." Two of Applicant Firm's proposed lines of business are proprietary trading and investment banking. Member Supervision determined that those activities require Series 57 and 79 registrations, respectively. While Applicant Firm concedes the need for the Series 79 for the firm's investment banking activities, and represents that Person A would take that exam, it disagrees with Member Supervision's determination that Owner needs the Series 57 to supervise the firm's proprietary trading. We agree with Member Supervision that both Series 57 and 79 are required.

a. Owner Lacked Series 57 Registration

Applicant Firm maintains that Owner does not need Series 57 registration because his Series 24 registration allows him to "supervise all areas" of the firm's business including "trading and market making." This is incorrect. FINRA Rule 1220 provides that "[e]ach principal . . . who is responsible for supervising" certain trading activities, including proprietary trading, "shall be required to register with FINRA as a Securities Trader Principal." FINRA Rule 1220(a)(7), (b)(4). The rule further provides that "[e]ach person seeking to register as a Securities Trader Principal shall, prior to or concurrent with such registration, become registered . . . as a Securities Trader and pass the General Securities Principal qualification examination." FINRA Rule 1220(a)(7). In order to become registered as a securities trader, a person must pass the Series 57 examination. FINRA Rule 1220(b)(4). Therefore, to supervise Applicant Firm's proprietary trading, Owner must pass the Series 24 and 57 examinations. Owner has not passed the Series 57 examination, and therefore he is not qualified to supervise the firm's proprietary trading.

Applicant Firm also argues that its proposed trading activity would not be true proprietary trading because it would use funds loaned from its parent company rather than its own funds. However, Rule 1220 does not carve out an exception for trading with loaned funds.

In addition, Applicant Firm maintains that Member Supervision did not raise any “further objections” to Applicant Firm’s arguments that Owner did not need the Series 57 registration to supervise the firm’s proprietary trading. In fact, Member Supervision gave Applicant Firm multiple opportunities to justify its position on Series 57 registration, highlighting FINRA’s published guidance and asking the firm to identify any authority supporting its contrary view. Applicant Firm failed to do so. Member Supervision is not required “to continue making repeated requests where an applicant repeatedly fails to adequately respond.” *Membership Continuance Application of the Firm*, 2014 FINRA Discip. LEXIS 42, at \*44–45 (FINRA NAC Sept. 29, 2014).

b. Person A Lacked Series 79 Registration

Applicant Firm proposed that Person A would engage in and supervise its investment banking business, which would include “structuring / pricing deals.” Associated persons who engage in “structuring ... and pricing” of “debt or equity securities offerings”—in addition to other related activities—must register as an investment banking representative. FINRA Rule 1220(b)(5)(A). Obtaining that registration requires passing the Series 79 qualification examination.

On appeal, Applicant Firm incorrectly argues that Person A was unable to take the Series 79 examination because of the pandemic. In fact, Person A sat for the exam on two occasions—in November 2019 and again in July 2020 (after Applicant Firm’s membership interview). He did not pass.

In the alternative, Applicant Firm argues that regardless of Person A’s lacking Series 79 registration, his Series 24 registration allows him to supervise all areas of Applicant Firm’s investment banking activities. The Series 24 examination assesses the competency of an entry-level principal to perform their job as a principal dependent on their corequisite registrations. “In addition to the Series 24 exam, candidates must pass the Securities Industry Essentials (SIE) Exam and a representative-level qualification exam . . . to hold an appropriate principal registration.”<sup>13</sup> FINRA’s guidance on Series 24 explicitly states that, for an investment banking principal, the “corequisite registration” is the Series 79. Thus, Person A’s Series 24 registration is not sufficient for supervising the firm’s investment banking activities.

Therefore, we agree with Member Supervision that Applicant Firm did not demonstrate that it satisfies the standards of FINRA Rule 1014(a)(2).

2. Applicant Firm Does Not Satisfy the Standard Set Forth in FINRA Rule 1014(a)(4)

FINRA Rule 1014(a)(4) requires the applicant firm to establish “all contractual or other arrangements and business relationships with banks, clearing corporations, service bureaus, or others” necessary to initiate operations and comply with securities regulations and rules. Applicant Firm’s failure to do so is factually without dispute. Applicant Firm failed to obtain a

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<sup>13</sup> <https://www.finra.org/registration-exams-ce/qualification-exams/series24>

fidelity bond, which is required by FINRA Rule 4360; failed to secure an audit engagement letter, as required by Securities Exchange Act of 1934 (“Exchange Act”) Rule 17a-5(f)(2); and failed to arrange for storage of its electronic records to comply with Exchange Act Rule 17a-4(b).

Applicant Firm states that it chose not to establish these contracts and arrangements until after its membership application was approved, despite Member Supervision’s explanation that it could not approve Applicant Firm’s membership until such contracts and arrangements were in place. Because of its failure to secure the requisite contracts or arrangements, Applicant Firm failed to demonstrate that it satisfies the standards of FINRA Rule 1014(a)(4)

3. Applicant Firm Does Not Satisfy the Standards Set Forth in FINRA Rule 1014(a)(10)

FINRA Rule 1014(a)(10) requires the applicant firm to establish that it has a “supervisory system . . . designed to prevent and detect, to the extent practicable, violations of the federal securities laws, the rules and regulations thereunder, and [FINRA] Rules.” According to FINRA Rule 1014(a)(10)(J), the applicant firm must establish the adequacy of the supervisory system based on, among other things, the nature of the proposed business; the number, experience (direct and indirect), and qualifications of supervisory personnel; and any other factors that “will have a material impact on the [firm’s] ability to detect and prevent violations.” FINRA Rule 1014(a)(10)(D) requires supervisors to have one year of direct experience or two years of related experience with the subject area to be supervised. Applicant Firm proposes that Person A would supervise its investment banking business and serve as the firm’s CCO. We agree with Member Supervision that the firm has not shown that Person A has the requisite experience to do either.

Applicant Firm maintains that Person A is qualified to supervise its investment banking activities because of his experience working at a bank. The firm does not explain, however, Person A’s specific role and responsibilities at the bank, how long he engaged in those activities, or how his experience relates to Applicant Firm’s proposed business. Instead, when Member Supervision asked for a detailed description of Person A’s specific experience within investment banking, the firm pointed to his work at the bank and made a conclusory declaration that he has experience in investment banking. When Member Supervision asked for additional details about his “specific responsibilities” relating to structuring and pricing deals, the firm failed to draw a connection between Person A’s background and his proposed role at the firm. Instead, Applicant Firm merely asserted that Person A was involved in due diligence, preparing prospectuses, and pricing private placements, without discussing his level of involvement.

Similarly, Applicant Firm contends that Person A is qualified to serve as its CCO because of his work at the bank (more than 20 years ago) and as a “Principal and FINOP” at Owner’s former broker-dealer. But again, Applicant Firm fails to draw a nexus between Person A’s background and his proposed role. Serving as a principal or FINOP involve different responsibilities than those of a CCO. Additionally, as noted by Member Supervision at the hearing, Person A’s previous broker-dealer was “inactive the entire time”— such that Person A would not have performed the duties required of either role. Applicant Firm’s failure to provide details about Person A’s experience and explain how it was related to his proposed roles as

investment banking principal and CCO support Member Supervision's conclusion that the firm did not satisfy FINRA Rule 1014(a)(10).<sup>14</sup>

4. Applicant Firm Does Not Satisfy the Standards Set Forth in FINRA Rule 1014(a)(1)

FINRA Rule 1014(a)(1) requires applications and supporting documents to be "complete and accurate." Member Supervision concluded that Applicant Firm's application failed to meet this standard because the firm did not have a "demo-ready" ATS platform, might not have intended to be an active firm, and did not disclose or sufficiently explain Owner's outside business activities. While we affirm Member Supervision's denial based on the firm's failure to meet the standards under FINRA Rule 1014(a)(1), we do so on more narrow grounds.

a. Failure to Have a "Demo-Ready" Platform

Member Supervision concluded that because Applicant Firm did not have a "demo-ready" ATS platform, its application was not complete. The firm acknowledged that it did not have a working platform, but believed that once its membership was approved, it could attract investors to build out its platform and develop a clearer business model.

The Subcommittee asked Member Supervision to explain the rule or policy that required an applicant firm to have a demo-ready platform available for presentation at the membership interview. Member Supervision responded that its authority arises from FINRA Rule 1014(a)(6), which requires Member Supervision to consider whether "the communications and operational systems that the Applicant intends to employ for the purpose of conducting business with customers and other members are adequate . . .," as well as Member Supervision's long-recognized inherent power to request such demonstrations. We agree with Member Supervision that this standard provides it with authority to require applicants, such as Applicant Firm, to demonstrate during the application process that their systems, including ATSs, are functional.

Member Supervision, however, did not cite FINRA Rule 1014(a)(6) as the basis for its denial in its decision. Instead, it stated that Applicant Firm's failure to have a working platform rendered it impossible for Member Supervision to determine whether the firm's ATS satisfied FINRA Rule 1014(a)(6), and therefore resulted in the firm's failure to satisfy FINRA Rule 1014(a)(1), which required the firm to provide the information Member Supervision needed to conduct its assessment.

We disagree with Member Supervision that Applicant Firm's failure to provide a demonstration of its ATS violated FINRA Rule 1014(a)(1). If Applicant Firm did not have a working ATS—which it did not—Member Supervision should have relied on FINRA Rule

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<sup>14</sup> Applicant Firm argues that Member Supervision failed to ask Person A any questions during the membership interview regarding his qualifications or experience. However, Member Supervision asked the firm multiple times before and after the membership interview to elaborate on Person A's experience and did not receive information that satisfied FINRA Rule 1014(a)(10).

1014(a)(6) for denial, not FINRA Rule 1014(a)(1). Member Supervision’s advancement of new grounds in defense of its decision for the first time in its post-hearing brief raises fairness concerns because Applicant Firm was not reasonably apprised of such a basis for denial. *See New Membership Application of Firm A*, Application No. 20090182345, 2010 FINRA Discip. LEXIS 24, at \*26 (FINRA NAC Sept. 28, 2010). Therefore, we cannot conclude that Applicant Firm’s failure to present a “demo-ready” platform supported denial pursuant to FINRA Rule 1014(a)(1).

b. Intent to Operate as an Active Broker-Dealer

Member Supervision also based its denial under FINRA Rule 1014(a)(1) on the grounds that Applicant Firm expressed conflicting sentiments with respect to whether it intended to operate as an “active” broker-dealer or instead to sell the firm and its patents and technology.<sup>15</sup> Applicant Firm argues that it has the right to sell its patents and technology and such a hypothetical sale has no bearing on the firm or its ATS. It further notes that the broker-dealer may need to lay dormant while it secures funding, and that it is unfair for Member Supervision to deny its application on the basis of speculative future conduct.

We agree with Member Supervision that the inconsistencies in Applicant Firm’s application and its statements about selling the broker-dealer call into question whether the firm truly intends to conduct the business for which it is seeking membership, rendering the application incomplete and inaccurate under FINRA Rule 1014(a)(1). In all ten iterations of the NMA, Applicant Firm represented that it intended to develop and operate an ATS, along with three other lines of business. However, in late June 2020, at its membership interview and in subsequent correspondence, Applicant Firm offered to “hand over all the patents ... and all technology already built to FINRA for a 3% royalty,” in contravention of its earlier representations. While “[t]he new membership application process allows [an applicant] some flexibility” to hone its application in response to concerns raised by Member Supervision, “at some point an application must reach substantially a point of rest to be deemed complete.” *New Membership Application of Firm A*, Application No. 20090196759, at \*12 (FINRA NAC Dec. 2010).<sup>16</sup> Applicant Firm’s eleventh hour modification of its business plan evinces that its application did not reach the point of rest.

In light of the uncertainty surrounding Applicant Firm’s intent to carry out the business described in its application, Member Supervision correctly concluded that the application did not satisfy FINRA Rule 1014(a)(1).<sup>17</sup>

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<sup>15</sup> Member Supervision maintains that FINRA’s By-Laws do not provide for dormant or inactive memberships.

<sup>16</sup> Available at: <http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/nacdecisions/p125380.pdf>.

<sup>17</sup> We do not find that FINRA Rule 1014(a)(1) requires an applicant to demonstrate that it will be an active broker-dealer. This standard for admission calls for disclosure and honesty, including the applicant giving complete and accurate responses when asked for additional

c. Failure to Disclose Outside Business Activities

Member Supervision concluded that Applicant Firm's NMA was not complete or accurate because it failed to disclose Owner's involvement with the cryptocurrency firm, Company D. Member Supervision also had concerns about the business activities conducted by Company C and its interaction with the Applicant Firm, both operationally and financially. Applicant Firm argues that Owner's involvement in Company D was not disclosed on Owner's Form U4 because "[it] was reviewed by the SEC legal counsel" and because at the time "[Owner] was not engaged in the securities business." It further argues that it provided Member Supervision with all relevant bank statements and sufficiently answered its questions.

We agree with Member Supervision that Applicant Firm's failure to disclose Company D as well as the firm's unspecific answers in response to questions about Company C render Applicant Firm's application incomplete and inaccurate under FINRA Rule 1014(a)(1). Owner was obligated to disclose in the firm's NMA all of his outside business activities. He cannot pick and choose which business activities to disclose because FINRA's disclosure rules apply to *all* outside business activities. See *Dep't of Enf't v. Connors*, Complaint No. 2012033362101, 2017 FINRA Discip. LEXIS 2, at \*24 (FINRA NAC Jan. 10, 2017); accord *Dep't of Enf't v. Akindemowo*, Complaint No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at \*39 (FINRA NAC Dec. 29, 2015) (FINRA Rule 3270 "extend[s] to all outside business activity"), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016). Furthermore, we agree with Member Supervision that the firm's description of Company C's business operations was vague and non-responsive. We therefore affirm Member Supervision's denial on these grounds.

5. Applicant Firm Does Not Satisfy the Standards Set Forth in FINRA Rule 1014(a)(13)

FINRA Rule 1014(a)(13) prohibits Member Supervision from approving a prospective firm's membership application if there is evidence that the firm "may circumvent, evade, or otherwise avoid compliance with the federal securities laws, the rules and regulations thereunder, or FINRA rules."<sup>18</sup> Owner's failure to disclose his ownership and control over Company D demonstrates that the firm has not satisfied this standard.

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[cont'd]

information and to keep the application current during the membership process. We do not understand it to include an active member requirement. We do not address here the contours of when a FINRA firm that is inactive may be in violation of Section 1(a) of Article III of FINRA's By-Laws.

<sup>18</sup> In light of our findings that Applicant Firm's failure to disclose Owner's outside business activities violates the standards in FINRA Rules 1014(a)(13), it is unnecessary to further address whether the firm's failure to present a feasible model of its business activities or its failure to obtain the licenses and registrations required to engage in the proposed business operations and lack of the requisite qualifications also violate this standard.



FINRA's rules and policies regarding disclosing outside business activities "address[] the securities industry's concern about preventing harm to the investing public or a firm's entanglement in legal difficulties based on an associated person's unmonitored outside business activities." *Connors*, 2017 FINRA Discip. LEXIS 2, at \*32 (in the context of FINRA Rule 3270). In addition, an associated person, such as Owner, has an obligation under FINRA rules to keep his or her Form U4 "current at all times" and update required information on the form as changes occur, but no later than 30 days after learning of the facts and circumstances that give rise to the reportable event. See Section 2(c) of Article V of the FINRA By-Laws. FINRA Rule 1122 provides that "[n]o member or person associated with a member shall file with FINRA information with respect to membership or registration which is incomplete or inaccurate so as to be misleading, or which could in any way tend to mislead, or fail to correct such filing after notice thereof." The rule is intended to ensure that an associated person's Form U4 contains accurate, up-to-date information so that regulators, employers, and members of the public "have all of the material, current information about the registered representative with whom they are dealing." *Michael Earl McCune*, Exchange Act Release No. 77375, 2016 SEC LEXIS 1026, at \*12 (Mar. 15, 2016), *aff'd*, 672 F. App'x 865 (10th Cir. 2016). Considering the importance of these disclosure requirements to regulators, FINRA's membership application program requires applicants to fully disclose all outside business activities and provide detailed information surrounding the scope of their business operations.

Owner's failure to update his Form U4 or otherwise disclose his involvement with Company D is a critically important failure. FINRA relies on member firms and associated persons to make complete and accurate disclosures. At the hearing, FINRA Employee 3 explained Member Supervision's concern about this failure to disclose:

[Company D] could potentially have a nexus to the Applicant Firm. It referenced potentially starting an exchange. I believe it made references to an ATS, not to Applicant Firm but possibly [another] ATS. But what it just kind of boils down to is we don't know if there's an impact or not. So it is something we would want to look at to see if there are any conflicts of interest, to see what the status is. So, yes, it's something we would definitely be interested in. There's definitely regulatory interest there.

Owner argues that, because Company D did not have any customers, there couldn't be a conflict of interest, and thus he did not need to disclose his affiliation. This demonstrates Owner's misunderstanding of his registration requirements and the importance of his disclosure obligations. This, coupled with the firm's nondescript responses concerning Company C's business operations and its relationship to the firm, validates Member Supervision's concerns. Applicant Firm's disregard for its membership obligations and lack of transparency with its future regulator supports the conclusion that the firm may might circumvent or evade federal securities laws or FINRA rules.

### C. Applicant Firm's Other Arguments on Appeal Fail

Applicant Firm makes several procedural arguments related to the underlying application process and the fundamental fairness of FINRA. Each argument fails.

1. The Membership Application Process Was Fair

Applicant Firm argues that because Owner had previously filed a lawsuit against FINRA, Member Supervision was biased. We disagree. Owner's decision to file a lawsuit against FINRA cannot create disqualifying bias for the department that reviews all new member applications. In any event, there is no evidence in the record to support bias. Moreover, we have conducted a de novo review, and have carefully considered all the evidence in the record as well as the hearing testimony, which "dissipates even the possibility of unfairness." *Robert Tretiak*, 56 S.E.C. 209, 232 (2003); *see also Robert E. Gibbs*, 51 S.E.C. 482, 484-85 (1993) (discussing how de novo review by the NASD Board during NASD disciplinary proceedings insulates against bias), *aff'd*, 25 F.3d 1056 (10th Cir. 1994) (table).

In addition, Applicant Firm maintains that Member Supervision failed to keep the firm adequately apprised of purported deficiencies in, or problems with, its application, including but not limited to the need to have Series 57 and 79 registrations and Member Supervision's concerns over Person A's relevant work experience.<sup>19</sup> Applicant Firm contends that Member Supervision should have reached out to assist it with resolving these issues, such as advising the firm to drop the problematic proposed lines of business from its application.<sup>20</sup> Again, we disagree. "While Member [Supervision] may opt to do so, such as when it benefits the efficiency of the overall membership application process, it is not mandated by the rules."<sup>21</sup> Rather, it is the applicant firm's burden to demonstrate that its application meets the standards for new membership, not FINRA's." *New Membership Application of Firm A*, Application No.

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<sup>19</sup> In its post-hearing submission, with respect to the Series 57 and 79 examinations, the firm offers "to provide completion of these exams within 6 months from the date the license issues or forfeit these business lines." We decline to consider this request. Any changes or amendments to the NMA should occur during the application process and not on appeal.

<sup>20</sup> At the hearing Owner explained his frustration over Member Supervision's perceived lack of assistance or collaboration:

Did FINRA at any time communicate to us, well, if you remove investment banking maybe we could issue this or if you move proprietary trading or if you do anything, was there anything what I would say what you consider good faith among the parties that some action might occur if we resolve any of the issues? Was there a single attempt made by FINRA to conduct a conference phone call with us in attempt to resolve the issues that FINRA had with us as any normal civil interactions between competent parties would have?

<sup>21</sup> FINRA Employee 3 had multiple conversations with Person A regarding the membership application. She testified that "[t]here were so many deficiencies with the application, that it wasn't a matter of us saying everything will be okay if you just take that structuring and pricing off the table. There was [sic]widespread deficiencies. [Member Supervision is] not in the position of changing the [firm's] business plan."

20090196759, at 12-13 (FINRA NAC Dec. 2010). Thus, the burden was on Applicant Firm, not FINRA, to make sure that it was aware of and able to meet the requisites for membership. In addition, Member Supervision gave Applicant Firm multiple opportunities to elaborate on Person A's experience, but the firm simply did not do so. In sum, Applicant Firm's "arguments confuse its inability to meet its burden under Rule 1014 with its assertion of an inherently unfair and futile process for reviewing NMA's." *Asensio & Co.*, 2012 SEC LEXIS 3954, at \*52-53. We therefore conclude that the application process was not unfair.

2. Applicant Firm's Additional Post-Hearing Arguments Fail

In its post-hearing submission, Applicant Firm argues that FINRA, as an organization, is fundamentally unfair. It argues that FINRA's qualification examinations are obsolete and impossible to pass, that FINRA favors the "big banks," and "average members" don't matter. Applicant Firm also blames FINRA for the general lack of capital formation for small companies. Finally, Applicant Firm notes that if its membership application is denied, all the firm's investors will lose money.

Regardless of the lack of veracity of any of these assertions, none is relevant to our review. Our role is to evaluate a firm's fitness for FINRA membership based upon the firm's ability to demonstrate that it meets FINRA Rule 1014(a)'s standards for membership. Here, we conclude that because Applicant Firm did not satisfy those standards for membership, Member Supervision properly denied the firm's membership application.

IV. Conclusion

Applicant Firm failed to demonstrate that it meets the standards of membership contained in FINRA Rules 1014(a)(1), (2), (4), (10), and (13). Accordingly, Member Supervision's decision to deny the firm's application for FINRA membership is affirmed.

On Behalf of the National Adjudicatory Council,

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Jennifer Piorko Mitchell,  
Vice President and Deputy Corporate Secretary