

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63933; File No. SR-FINRA-2010-056)

February 18, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Adopt FINRA Rule 1113 (Restriction Pertaining to New Member Applications) and to Amend the FINRA Rule 9520 Series (Eligibility Proceedings)

I. Introduction

On November 1, 2010, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt new FINRA Rule 1113 (Restriction Pertaining to New Member Applications) and to amend the FINRA Rule 9520 Series (Eligibility Proceedings) to restrict new member applicants’ and certain members’ association with disqualified persons. The proposed rule change was published for comment in the Federal Register on November 22, 2010.³ The Commission received three comment letters on the proposed rule change.⁴ FINRA responded to these comments in a letter dated February 4, 2011.⁵ This order approves the proposed rule change.

II. Description of Proposal

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 63316 (Nov. 15, 2010), 75 FR 71166 (Nov. 22, 2010) (“Notice”).

⁴ See letter from Board of Directors, ASG Securities Inc., to the Commission, dated Dec. 13, 2010 (“ASG Letter”); letter from Manuel P. Asensio-Garcia, to the Commission, dated Dec. 20, 2010; and, letter from Manuel P. Asensio-Garcia, to Robert W. Cook, Director, Division of Trading and Markets, dated Dec. 20, 2010 (Because both letters from Mr. Asensio raise substantially the same issues with respect to the proposed rule change, they are addressed in this order as a single comment letter, collectively referred to herein as the “Asensio Letter”).

⁵ See letter from Patricia M. Albrecht, Assistant General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated Feb. 4, 2011 (“FINRA Response”).

Article III, Section 3(b) of the FINRA By-Laws provides that no person shall be associated with a member, continue to be associated with a member, or transfer association to another member if such person is or becomes subject to a disqualification; and, that no person shall be admitted to membership, and no member shall be continued in membership, if any person associated with it is subject to a disqualification. Pursuant to Article III, Section 4 of the FINRA By-Laws, a person is subject to a “disqualification” with respect to membership, or association with a member, if such person is subject to any “statutory disqualification” as such term is defined in Exchange Act Section 3(a)(39).⁶

The FINRA Rule 9520 Series sets forth procedures for a person to become or remain associated with a member, notwithstanding the existence of a statutory disqualification, and for a current member or person associated with a member to obtain relief from the eligibility or qualification requirements of the FINRA By-Laws and rules. The FINRA Rule 9520 Series also contemplates that a new member applicant may sponsor a proposed associated person or itself for relief from the eligibility or qualification requirements. A member (or new member applicant) seeking to associate with a person subject to a disqualification must seek approval from FINRA by filing a Form MC-400 application, pursuant to the FINRA Rule 9520 Series. Members (and new member applicants) that are themselves subject to a disqualification that wish to obtain relief from the eligibility requirements are required to submit a Form MC-400A application.

⁶ See 15 U.S.C. 78c(a)(39). Pursuant to Exchange Act Section 3(a)(39), a person is subject to a “statutory disqualification” with respect to membership or participation in, or association with a member of, a self-regulatory organization (“SRO”) if such person, among other things: (1) has been convicted of certain misdemeanors or any felony criminal convictions within the ten years preceding the date of the filing of an application for membership or participation in, or to become associated with a member of, such SRO; (2) is subject to a temporary or permanent injunction (regardless of its age) issued by a court of competent jurisdiction involving at least one of a broad range of unlawful investment activities; (3) has been expelled or suspended from membership or participation in an SRO; or, (4) is subject to an SEC order denying, suspending, or revoking broker-dealer registration.

FINRA proposed to adopt new FINRA Rule 1113 (Restriction Pertaining to New Member Applications) and to amend the FINRA Rule 9520 Series (Eligibility Proceedings) to further restrict new member applicants' and certain members' association with disqualified persons.

New FINRA Rule 1113 would direct FINRA's Department of Member Regulation ("Department") to reject an application for FINRA membership⁷ in which either the applicant or an associated person of the applicant, as defined in Article I of the FINRA By-Laws,⁸ is subject to a statutory disqualification, as defined in Article III, Section 4 of the FINRA By-Laws.⁹ The proposed new rule would also provide that any new member application that the Department approves due to a Department or applicant error (including, but not limited to, an inadvertent or intentional misstatement or omission by the applicant or associated person) shall be subject to membership cancellation in accordance with FINRA Rule 9555 (Failure to Meet the Eligibility or Qualification Standards or Prerequisites for Access to Services).

The proposed amendments to the FINRA Rule 9520 Series, which sets forth the eligibility proceedings for membership, would have the following effects: first, they would

⁷ Proposed FINRA Rule 1113, by its terms, would not apply to a member submitting a continuing membership application pursuant to NASD Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations).

⁸ Article I of the FINRA By-Laws defines an "associated person" as a: (1) a natural person who is registered or has applied for registration under FINRA rules; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under its By-Laws or rules; and (3) for purposes of FINRA Rule 8210, any other person listed in Schedule A of Form BD of a member. See FINRA By-Laws, Article I (rr) (definition of "person associated with a member" or "associated person of a member").

⁹ As previously noted, Article III, Section 4 of the FINRA By-Laws incorporates the definition of "statutory disqualification" as such term is defined in Exchange Act Section 3(a)(39).

amend the FINRA Rule 9520 Series definition of “sponsoring member”¹⁰ to eliminate the reference to new member applicants. FINRA believes that because new member applicants do not have any prior operating or supervisory history there is nothing to indicate the necessary experience to supervise disqualified persons. FINRA believes that the proposed amendment would alleviate its concerns about the ability of new member applicants to supervise adequately a disqualified person. Furthermore, FINRA believes this amendment would conform to the proposed new membership application rule (FINRA Rule 1113), discussed above, by precluding new member applicants from being able to sponsor disqualified persons.¹¹

Second, the proposed rule change would amend the definition of “disqualified member”¹² in the FINRA Rule 9520 Series to clarify that a new member applicant is not eligible to submit an application for relief under the FINRA Rule 9520 Series if the new member applicant itself is subject to a disqualification. FINRA believes a new member applicant should enter FINRA membership free of the supervisory and operating concerns raised by association with a statutorily disqualified person or being itself subject to a statutory disqualification and believes this proposed rule change is consistent with that belief.

Third, the proposed rule change would further amend the definition of “sponsoring member” to preclude any member from sponsoring the association or continued association of a disqualified person, who is directly or indirectly a beneficial owner of more than five percent of the sponsoring member, to be admitted, readmitted, or permitted to continue in association.

FINRA believes that a member cannot effectively supervise a disqualified person in light of the

¹⁰ FINRA Rule 9521(b)(4).

¹¹ The proposed rule change also would make conforming amendments throughout the FINRA Rule 9520 Series to reflect the proposed amendment discussed above that a new member applicant may not sponsor a person subject to a disqualification.

¹² FINRA Rule 9521(b)(2).

inherent conflict of interest resulting from the disqualified person's ownership interest in the member. FINRA believes the proposed amendment to the definition of "sponsoring member" would address this issue.

III. Discussion of Comment Letters

One commenter, Manuel P. Asensio-Garcia, a principal of Asensio & Company, Inc. ("ACO"), submitted a letter opposing the proposed rule change on several grounds.¹³ First, the Asensio Letter asserts that the proposed rule change was an improper attempt to adversely impact a New Member Application Form ("NMA") filed by ACO and concurrent MC-400 application filed by ACO on Mr. Asensio's behalf. In the FINRA Response, FINRA contests this assertion. Specifically, the FINRA Response states that the proposed rule change is a separate policy-driven proceeding based on its belief that a new member applicant should enter FINRA membership free of the supervisory and operating concerns raised by association with a statutorily disqualified person or being itself subject to a statutory disqualification.¹⁴ The FINRA Response further notes that the proposed rule change would apply only to NMAs and applications for relief from a statutory disqualification filed on or after the effective date of the proposed rule change and, consequently, would not impact any applications pending before such effective date.

The Asensio Letter also states that the proposed rule change was unnecessary because FINRA already has authority under its current rules to deny an NMA based on the existence of a statutory disqualification and to deny an MC-400 application based on the fact that a disqualified

¹³ Asensio Letter.

¹⁴ FINRA Response.

person is proposing to associate with a new member.¹⁵ The FINRA Response contests this assertion by citing the public policy interests underlying the proposed rule change’s objective – to promote initiation of FINRA membership free of statutory disqualification concerns. Moreover, FINRA believes the proposed rule would allow FINRA to conserve regulatory resources that would otherwise be devoted to considering an NMA or MC-400 application that the proposed rule change would preclude at the outset.¹⁶

The Asensio Letter also states that the proposal would effectively foreclose use of the eligibility proceedings by a disqualified person seeking relief from FINRA sanctions. Specifically, the Asensio Letter states that the eligibility proceedings represent the only avenue for seeking relief outside of an appeal and to effectively use the eligibility proceedings for this purpose, a disqualified person must be able to create a new member applicant to be his sponsor; otherwise, a disqualified person cannot present his arguments for relief free from possible restrictions that could be imposed by a member sponsor.¹⁷ The FINRA Response states that the eligibility proceedings are not the appropriate forum for reviewing sanctions imposed in a formal disciplinary action brought by FINRA; rather, the correct process for an individual to challenge any FINRA-imposed sanctions is set forth in the FINRA Rule 9300 Series (Review of Disciplinary Proceeding By National Adjudicatory Council and FINRA Board; Application for SEC Review).¹⁸ Accordingly, FINRA believes this objection lacks merit.¹⁹

¹⁵ Asensio Letter.

¹⁶ FINRA Response.

¹⁷ Asensio Letter.

¹⁸ FINRA Response.

¹⁹ The Asensio Letter also describes the foreclosure of a review of a FINRA-imposed sanction through the eligibility proceedings as “contrary to the most basic ideals of constitutional due process.” As referenced above, FINRA believes that the eligibility proceedings are not the appropriate forum for reviewing FINRA-

The second commenter, ASG Securities, did not oppose the proposed rule change but requested that FINRA amend the proposal to (1) extend from ten business days to twenty business days the period in FINRA Rule 9522(a)(3) (Notice Regarding an Associated Person) during which a member may file a Form MC-400A application for itself and an associated person upon receiving a disqualification notice from FINRA staff; and (2) prohibit a disqualified person or entity from financing a member or providing or lending funds to an associated person for re-investment into a member.²⁰ The FINRA Response states that the commenter's suggestions are outside the scope of the rule proposal; as such, it does not intend to expand the proposal to address these additional issues at this time. However, it will consider whether to propose additional changes at a later date.²¹

IV. Discussion and Commission Findings

The Commission has carefully reviewed the proposed rule change, the comments received, and FINRA's response to the comments, and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.²² In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,²³ which, among other things, requires that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public

imposed sanctions; however, a process does exist for individuals to challenge a FINRA-imposed sanction. As such, FINRA also believes the Asensio Letter's argument lacks merit.

²⁰ ASG Letter.

²¹ FINRA Response.

²² In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²³ 15 U.S.C. 78o-3(b)(6).

interest. In particular, the Commission agrees that a new member applicant should enter FINRA membership free of the supervisory and operating concerns raised by association with a statutorily disqualified person or being itself subject to a statutory disqualification.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁴ that the proposed rule change (SR-FINRA-2010-056), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁵

Cathy H. Ahn
Deputy Secretary

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).