

# Broker-Dealer Registration and FINRA Membership Application

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Following is an overview of the federal, state and self-regulatory organization (“SRO”) requirements for registration and qualification as a broker-dealer in the United States. We also discuss certain considerations relevant to the decision to register a broker-dealer with the U.S. Securities and Exchange Commission (“SEC” or the “Commission”), application for membership in the Financial Industry Regulatory Authority (“FINRA”) and other SROs, state registration and related costs.

- I. Jurisdiction ..... 2
- II. Exclusions from Registration ..... 2
- III. Broker-Dealer Registration and SRO Membership..... 3
  - A. SEC Registration ..... 3
  - B. FINRA and Other SRO Membership ..... 3
  - C. State Registration ..... 6
  - D. Time and Expenses ..... 6
- IV. Net Capital and Operations..... 6
  - A. Net Capital Requirements ..... 6
  - B. Interim and Continuing Service Arrangements..... 8
  - C. Clearance and Settlement ..... 8
- Appendix A..... 9
  - Documents and Fees for Broker-Dealer Registration ..... 9
- Appendix B..... 12
  - Timeline ..... 12

## I. Jurisdiction

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Broker-dealers are subject to regulation by the SEC, FINRA and any other SROs (such as stock exchanges) of which they are members, as well as the states in which they do business.<sup>1</sup>

The Securities Exchange Act of 1934 (the “Exchange Act”) requires the registration of any broker-dealer effecting securities transactions by means of interstate commerce. The various states’ securities laws also regulate broker-dealers within their jurisdictions and, unless an exemption is available, require registration by any broker-dealer conducting business from or with persons in the state, as well as the registration as agent of such broker-dealer’s employees doing business in the state.

The SEC has advised that persons or entities that regularly (i) participate in the solicitation, negotiation or execution of securities transactions, (ii) receive transaction-based compensation contingent on the value or success of securities transactions or (iii) handle investor funds or securities, may be required to register as brokers. Persons or entities that (i) hold themselves out as being willing to buy and sell securities on a continuous basis or (ii) originate securities that they buy and sell may be required to register as dealers. Accordingly, underwriters, brokers, market makers and other dealers doing business in the United States generally must register as broker-dealers in accordance with Section 15(b) of the Exchange Act. In addition, certain finders, investment bankers, placement agents, investment advisers, financial consultants and persons or entities providing services to broker-dealers may be required to register as broker-dealers if they engage in one or more activities characteristic of brokers or dealers.

These guidelines generally apply to state registration of broker-dealers as well.

## II. Exclusions from Registration

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Certain categories of persons are either excluded from the definition of broker-dealer or exempt from registration. There are exceptions from the definitions of broker and dealer for certain banking activities. Issuers (such as private investment funds) selling their own securities through affiliates and employees who meet certain specified conditions are exempted from registration. Finders who act as intermediaries bringing together two parties to a transaction may be exempt from registration under limited circumstances. Foreign broker-dealers meeting specified requirements are also exempt from registration. U.S. investment advisers that effect trades or conduct other brokerage-type functions generally are not required to register as broker-dealers since such activities are considered incidental to their business as advisers.<sup>2</sup> M&A brokers that effect transactions solely involving the transfer of ownership and control of privately-held companies that do not exceed certain earnings or revenue thresholds (\$25 million in EBITDA or \$250 million in gross revenue) to buyers who will operate those companies are not required to

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<sup>1</sup> The scope of a broker-dealer’s ongoing regulatory and compliance obligations are considerable. While outside the scope of this overview, these obligations are discussed in detail elsewhere on our website.

<sup>2</sup> The adviser must not receive any special compensation for these activities.

register. While these exclusions are beyond the scope of this overview, we discuss them in detail in other material posted on our website.

### III. Broker-Dealer Registration and SRO Membership

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#### A. SEC Registration

In order to register as a broker-dealer, an application must be made to the SEC and to an SRO, generally FINRA.

Registration is accomplished by filing an application with the SEC under Section 15(b) of the Exchange Act. Under Section 15(b)(1), the SEC must, within 45 days, either issue an order granting registration or institute proceedings to determine whether registration should be denied.<sup>3</sup> An order granting registration does not become “effective,” however, until the broker-dealer becomes a member of FINRA.

Under SEC Rule 15b1-1, an application must be filed on Form BD through FINRA’s Central Registration Depository (CRD) system. The CRD system was developed by FINRA and the North American Securities Administrators Association — an organization of state securities regulators — to enable applicants to use a single form and combined payment to apply for registration and membership in multiple jurisdictions and FINRA.

Form BD consists of 13 items, plus schedules. Among other things, Form BD requires disclosure of the following information about the registrant:

1. the chain of ownership,
2. any affiliations with other entities in the securities or investment advisory businesses,
3. the officers and directors, and
4. the types of business activities to be conducted.

In addition, information must be disclosed regarding disciplinary history (including crimes, violations of securities or investment-related laws or rules of domestic or foreign financial regulatory authorities, and proceedings that might result in a finding of such violation) involving the registrant’s owners, registered employees, affiliated entities, and individuals holding senior management positions with affiliated entities. Form BD constitutes the entire application for registration with the SEC.

#### B. FINRA and Other SRO Membership

Application for membership in FINRA requires completion of a standardized online Form NMA (New Member Application). Form NMA is organized according to the twelve standards for FINRA membership

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<sup>3</sup> Grounds for denial of registration include the failure to disclose information required in the application or the previous sale of securities in violation of registration requirements.

itemized in NASD Rule 1014. Evidence of compliance with each standard involves the submission of comprehensive information, data and supporting documentation. Certain information is classified as mandatory, including:

- > detailed financial and source of capital information,
- > an organization chart,
- > a detailed description of the proposed business activities identified on Form BD,<sup>4</sup>
- > information regarding material contractual arrangements and business relationships supporting the business, and
- > written supervisory policies, procedures and controls.

Additional detail regarding the information required by Form NMA is attached at Appendix A.

Filing of Form NMA must be preceded by an application for approval of the firm's name (using the Broker- Dealer Firm Name Reservation Request Form) and submission of the following hardcopy forms: Form BD, Email Notification Contact Form, New Assessment Report and New Organization Super Account Administrator (SAA) and FINRA Entitlement Agreement (FEA) Form for access to Web CRD. Once the firm is approved for access to Web CRD, it should electronically submit its Forms U4 (for individual broker registration), Forms BR (for registration of any branch offices) and any subsequent amendments to its Form BD over Web CRD.<sup>5</sup> During the application process, the broker-dealer is also expected to become a member of the Securities Investor Protection Corporation (SIPC), to obtain a fidelity bond and to complete a Lost or Stolen Securities Program registration.

As part of the application process, principal officers and other persons associated with the broker-dealer who would be engaged in the firm's securities or investment banking business, supervision of those activities or the firm's day-to-day management must register (on Form U4), be fingerprinted and pass specified qualifying examinations.

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<sup>4</sup> Previously, applicants had to submit a business plan comprehensively describing all material aspects of the business to be conducted upon registration, including, among other items, trial balance and net capital computations, projections, intended location of the business, types of securities offered, advertising plans, description of the facilities including the proposed lease, number of markets to be made, plans to enter into any contractual arrangements such as underwriting, plans for any proprietary positions, a description of the communications and operational systems employed to conduct business and business continuity plans. The business plan requirements have essentially been subsumed into the questions in the revised Form NMA. Nevertheless, FINRA still encourages applicants to provide a business plan.

<sup>5</sup> It is not uncommon for applicants to defer submitting Forms U4 for proposed associated persons who, at the time of filing of the membership application, are employed at other member firms. While FINRA does not mandate that Forms U4 be filed prior to or concurrent with the filing of Form NMA, it encourages applicants to file the forms as early as possible in the application process in order to avoid delaying that aspect of its review.

- > The firm must have at least two fully qualified general securities principals and a financial and operations principal (FINOP).<sup>6</sup>
- > The chief executive officer and all other supervisory principals generally must pass the Series 7 and Series 24 examinations; the FINOP must pass the Series 27 examination.
- > Registered representatives generally must pass the Series 7 examination, as well as the Series 63 Uniform State Law examination.<sup>7</sup>

Once qualified, registered persons become subject to continuing education requirements.

Two of the most important parts of the FINRA application are the broker-dealer's written supervisory procedures and continuing education program.

The supervisory system should be designed to accomplish the following objectives: (1) prevent insider trading as required by Section 15(g) of the Exchange Act, (2) serve as the broker-dealer's system of supervision as required by FINRA Rule 3110 and (3) provide a defense against liability for the failure to supervise by the firm and its employees under Sections 15(b)(4) and 15(b)(6) of the Exchange Act, respectively. FINRA Rule 3110 provides that the broker-dealer must have written supervisory procedures reasonably designed to prevent and detect violations of the securities laws and FINRA rules.

FINRA Rule 1250 requires the continuing education of registered persons associated with the broker-dealer. FINRA Rule 1250 provides for a "Regulatory Element" and a "Firm Element." The Regulatory Element is a computer-based training program administered by FINRA. It is required for each registered person on the second anniversary of his or her securities registration and every three years thereafter. The Firm Element applies to all registered persons who have direct contact with customers and are engaged in sales, trading or investment banking activities, operations professionals and research analysts and to the immediate supervisors of such persons. The content of the Firm Element is largely left to the broker-dealer's determination; however, training programs must meet minimum standards and must focus on the particular investment products and services that the broker-dealer offers to customers. The information provided regarding the broker-dealer's continuing education program should focus on the Firm Element and include an evaluation of the firm's training needs and a written training plan.

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<sup>6</sup> FINRA may, at its discretion, waive the two principal requirement for small member firms.

<sup>7</sup> There are a series of special examinations for limited purpose principals and representatives that are shorter in content and duration than the general examinations identified above. These include the Series 28 "Introducing Broker/Dealer Financial and Operations Principal" for FINOPs of broker-dealers that do not carry customer accounts or hold customer funds or securities, the Series 62 "Corporate Securities Limited Representative" for representatives that limit their activities to the sale of public offerings and private placements of securities, the Series 79 "Limited Representative – Investment Banking" for representatives who engage in certain specified activities in connection with public offerings of securities, private placements or M&A transactions (but not selling activities), the Series 82 "Limited Representative – Private Securities Offerings Representative" for representatives that limit their activities to private placements, the Series 86 and 87 for research analysts and the Series 99 for Operations Professionals. Some positions require examinations in addition to the Series 7, such as equity traders, who must take the Series 55 examination. Assistant representatives accepting unsolicited customer orders for processing must pass the Series 11.

### **C. State Registration**

In addition to registration with the SEC and FINRA membership, a broker-dealer must register in any state from or into which the broker-dealer intends to conduct a securities business, unless an appropriate exemption is available. The broker-dealer's agents doing business in any state in which their firm is registered must also become registered in those states. An exemption for transactions with institutional customers is available in most states, but not all. In some states, such as California and New York, the institutional exemption is so limited that it is necessary to register in order to deal with most institutional customers.<sup>8</sup>

A salesperson must pass the Series 63 Uniform State Law examination in order to qualify as a registered agent in the states.

### **D. Time and Expenses**

It typically takes at least one to two months to prepare the initial SEC and FINRA applications depending upon several factors, including the size and complexity of the business, the types of compliance and operational protocols that need to be developed, the number of employees to be registered and the time it takes to gather the necessary information, including disciplinary information covering the broker-dealer's employees and affiliates. The application fee ranges from \$7,500 to \$55,000 depending on the size of the new member applicant, plus additional fees for principal and representative registrations and exams. A partial checklist of items required for registration with the SEC, FINRA and the states, as well as related fees, is included at Appendix A and a timeline for the organization process is attached as Appendix B.

New member applications are handled by FINRA's Membership Application Program ("MAP") Group located in New York. Evaluation of an application should be expected to take approximately four to six months (measured from the time the completed application has been filed), but could take a longer or shorter time depending on the number of requests for additional information by the staff and the ability of personnel to take and pass the appropriate registration examinations. The MAP Group operates a fast-track review process for low-risk, low-complexity applications as determined by the staff.<sup>9</sup>

## **IV. Net Capital and Operations**

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### **A. Net Capital Requirements**

Different capital requirements apply to registered broker-dealers according to the extent of their involvement in customer transactions and whether they hold funds or securities for customers. SEC Rule 15c3-1 (the "Net Capital Rule") requires minimum net capital of:

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<sup>8</sup> Proskauer can provide a Blue Sky survey that addresses the available exemptions in each state.

<sup>9</sup> If an application is deemed eligible for fast-track review, the firm must agree in writing to abbreviated turnaround times for responding to the staff's requests for information.

- i \$250,000 for a broker-dealer that holds customer funds or securities,
- ii \$100,000 for a broker-dealer that clears customer transactions on a delivery versus payment basis and does not offer margin accounts or trade as principal for its own account,
- iii \$50,000 for a broker-dealer that introduces customer transactions and accounts to another registered broker-dealer that carries the accounts on a fully disclosed basis or
- iv \$5,000 for a broker-dealer that does not receive, hold or owe customer funds or securities or carry customer accounts or trade securities other than on an agency or riskless principal basis.<sup>10</sup>

A broker-dealer that limits its activities in customer-related transactions according to clauses (ii) or (iii) above is exempt from SEC Rule 15c3-3 (the “Customer Protection Rule”), while a broker-dealer that limits its activities in accordance with clause (iv) would not be subject to the Customer Protection Rule at all. Thus, a broker-dealer that conducts an institutional brokerage business strictly on a delivery versus payment basis can operate with a minimum of \$100,000 net capital with an exemption from the Customer Protection Rule under paragraph (k)(2)(i);<sup>11</sup> while a broker-dealer that conducts its business through a registered clearing firm can operate with a minimum of \$50,000 net capital with an exemption from the Customer Protection Rule under paragraph (k)(2)(ii). (A portion of this amount could consist of a subordinated loan in a prescribed form from the broker-dealer’s parent or affiliate.) A corporate private placement or financial advisory firm that does not carry customer accounts can operate with a minimum of \$5,000 net capital.

The broker-dealer also must comply with the “basic” or “alternative” maximum debt-to-equity ratio requirements as prescribed by paragraph (a)(1) of the Net Capital Rule. Under the basic method, the broker-dealer must limit its “aggregate indebtedness,” as defined by the Rule, to no more than 800 percent of net capital for the first year of operation; and 1,500 percent of net capital thereafter. Under the alternative method, the broker-dealer must maintain net capital of not less than \$250,000 or two percent of its customer-related receivables computed according to the “Special Reserve Formula” in Exhibit A to

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<sup>10</sup> A broker-dealer that would serve as a chaperoning firm for a foreign broker-dealer pursuant to SEC Rule 15a-6(a)(3) is subject to a minimum net capital requirement of \$250,000 unless it has entered into a fully disclosed carrying agreement with another registered broker-dealer that has agreed, in writing, to comply with the SEC’s financial responsibility rules with respect to the chaperoning arrangement. A chaperoning broker-dealer that has entered into such a carrying agreement is subject to a minimum net capital requirement of \$5,000 or such other greater amount as would be required under Rule 15c3-1 based on the broker-dealer’s activities.

<sup>11</sup> Under paragraph (k)(2)(i) of Rule 15c3-3, a broker-dealer is exempt from the Customer Protection Rule if it carries no margin accounts; promptly transmits (i.e., by noon of the business day following receipt) all customer funds and securities received and does not otherwise hold or owe money or securities to customers; and effectuates financial transactions with customers through one or more bank accounts designated as a special account for the exclusive benefit of customers. Subparagraph (i) allows a firm to clear customer transactions on a delivery versus payment basis. Customer funds or securities can be maintained only under certain conditions for a limited period of time. The transactions need not be conducted through the bank account described above if the customer is an institution and the delivery takes place contemporaneously with the receipt of payment.

the Customer Protection Rule. A broker-dealer subject to a \$5,000 minimum net capital ordinarily would elect to compute under the basic method.

## **B. Interim and Continuing Service Arrangements**

Pending approval of the FINRA application, a broker-dealer cannot engage in any activities for which registration is required, including providing corporate finance advice that would involve either (i) the solicitation, negotiation or execution of securities transactions or (ii) the receipt of transaction-based compensation (including fees contingent on the value or success of resulting transactions). Individuals wishing to provide such services on an interim basis would have to be associated and registered with an appropriately licensed, “friendly” broker-dealer and that firm would have to be party to the engagement.

To facilitate operations, a broker-dealer may enter into an agreement with a parent or affiliate to provide office space, employment or technical support, such as accounting, record keeping and other administrative services (and share related expenses) pursuant to a service agreement between the parties subject to FINRA approval.

## **C. Clearance and Settlement**

A broker-dealer may conduct its brokerage business as a self-clearing broker, or it may clear through another

U.S. clearing firm. If the broker-dealer elects to clear its own transactions, but clears solely on a delivery- versus-payment (DVP) basis (generally applicable for institutional accounts only), the broker-dealer would not be required to comply with other provisions of the Customer Protection Rule.<sup>12</sup>

No clearance or settlement activity with respect to securities may be conducted by a broker-dealer subject to \$5,000 minimum net capital.

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We would be pleased to assist you in structuring your securities activities in compliance with the Exchange Act, including registration as a U.S. broker-dealer, reliance upon available exemptions and development of appropriate compliance and supervisory procedures.

Please contact us if you have any questions regarding the topics addressed in this summary.

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<sup>12</sup> Because such a U.S. broker-dealer clears (albeit on a DVP basis) the relevant transactions in accordance with Rule 15c3-3(k)(2)(i), it is characterized as a “clearing firm” for purposes of Rule 15c3-1. Accordingly, the broker-dealer is subject to a minimum net capital requirement of \$100,000. However, since the broker-dealer does not hold customer funds or securities, it is not characterized as a “carrying” firm. Therefore, the higher minimum net capital requirement of \$250,000 for a carrying firm is inapplicable. See Securities Exchange Act Release No. 34-31511 (Nov. 24, 1992).



## Appendix A

### Documents and Fees for Broker-Dealer Registration

Application	
<u>Item</u>	<u>Fees</u>
<b><u>SEC</u></b>	
Form BD	No fee
<b><u>FINRA</u></b>	
A. Broker-dealer Firm Name Reservation Request Form	No fee
B. Hardcopy forms: <ul style="list-style-type: none"> <li>&gt; Form BD</li> <li>&gt; Email Notification Contact Form</li> <li>&gt; New Organization Super Account Administrator and FINRA Entitlement Agreement Form</li> <li>&gt; New Member Assessment Report</li> </ul>	Form BD: US\$155 for a Form BD that contains a disclosure event; otherwise, no fee
C. Form U4 for each individual being registered, Form BR for each branch and any amendments to Form BD (must be electronically filed once FINRA Entitlement access credentials have been received) (the filing of the Form U4 also constitutes an application for each examination requested)	<p>Form U4: US\$125 per individual (US\$155 for any Form U4 containing a disclosure event)</p> <p>Exam fees are:</p> <ul style="list-style-type: none"> <li>&gt; US\$300 for Series 7;</li> <li>&gt; US\$147 for Series 63;</li> <li>&gt; US\$175 for Series 24;</li> <li>&gt; US\$175 for Series 27;</li> <li>&gt; US\$80 for SEI;</li> </ul> <p>(Various other fees apply for the limited purpose exams)</p> <p>Form BR: US\$75 per branch office (waived for one branch per firm)</p>
D. Form NMA containing:	New member application fee ranges from US\$7,500 to US\$55,000 depending on the applicant's size. An additional US\$5,000 surcharge is assessed on any new member that intends to engage in any clearing and carrying activities. The applicant's CRD account must be pre-funded prior to filing of Form NMA

Application	
<u>Item</u>	<u>Fees</u>
1. Full scope of business activities (detailed descriptions) including compensation practices; proprietary activity; market-making; types of customers (including a description of how the applicant intends to develop its customer base and offer and sell products and services to customers); officer, director, owner and control person information; branch office information and non-branch locations; anticipated number of personnel; management organizational chart; organizational charts and formation documents for relevant entities	
2. Licences and registrations (SROs, states); waiver applications, if any; registration in the Securities Information Center's Lost and Stolen Securities Program unless exempt from registration; attestation from any persons not involved in day- to-day securities and investment banking operations that registration is not required	
3. Adjudicated and pending disclosure events (including copies of actions, orders, statements of claim, settlements etc.); if necessary, support to rebut the presumption that the application for membership should be denied where the applicant or its associated persons are the subject of specified disqualification or other events	
4. Contractual and business arrangements with banks, clearing corporations, service bureaus etc.; expense sharing arrangements; auditor information; fidelity bond; clearing, commission sharing and other agreements; arrangements with electronic storage media vendors	
5. Description of facilities and copies of proposed and final lease; information regarding space sharing arrangements, if any	
6. Description of communications and operational systems used to conduct business; plans to ensure business continuity; use of social media	

Application	
<u>Item</u>	<u>Fees</u>
7. Nature and source of the applicant's capital; financing arrangements; activity that could have a material impact on the firm's net capital; plans for additional funding of the applicant in the event it becomes necessary (including evidence of source of funds and monthly income and expense projections)	
8. Information regarding financial controls, including written procedures; qualifications and experience of the FINOP; any outside activities of the FINOP; FINOP agreement	
9. written compliance and supervisory procedures and controls and internal operating procedures; sample reports used to support supervisory processes; written acknowledgement that heightened supervision may be required for any associated person with a disciplinary history	
10. Supervisory structure including experience of principals and supervisory duties; CCO qualifications and experience	
11. Information regarding recordkeeping systems; sample copies of proposed books and records	
12. Continuing Education Program information, including training plan	
E. Fingerprint Fees	US\$31.25 per individual for fingerprints submitted electronically; US\$41.25 for fingerprints submitted by a hard copy fingerprint card
F. SIPC Registration	
There is a pre-membership interview prior to approval of the application.	
<b><u>STATES</u></b>	
All states require filing of Form BD. Additional registration forms and filing fees vary from state to state. All states require a Form U4 for each individual being registered. An updated version of the SRO/Jurisdiction Fee and Setting Schedule is available on FINRA's website.	

## Appendix B

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### Timeline

- > Organize the Broker-Dealer Entity (1-3 days)
- > Prepare and File Form BD with the SEC (up to 1 month to prepare)
- > Submit proposed name to FINRA's Regulatory Review and Disclosure Department for review
- > Submit hardcopy forms to FINRA (see Annex A) and obtain access to the online Gateway system
- > Prepare and File Form NMA (1-2 months to prepare)
- > File Forms BR, U4, and Fingerprint Cards for Associated Persons
- > FINRA Evaluation and Requests for Additional Information (3+ months)
- > FINRA Membership Interview (1 day)
- > Further FINRA Request for Additional Information
- > FINRA Approval (1 month)

Total Time: Approximately 4-6 months from filing

Note: Pending approval of the FINRA application, the broker-dealer may not engage in any activities requiring registration that would involve (i) the solicitation, negotiation or execution of securities transactions or (ii) the receipt of transaction-based compensation (including fees contingent on the value or success of resulting transactions).

We would be pleased to assist you in structuring your securities activities in compliance with the Exchange Act, including registration as a U.S. broker-dealer, reliance upon available exemptions and development of appropriate compliance procedures.

Please contact us if you have any questions regarding the topics addressed in this summary.

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