

# Broker-Dealer Registration and FINRA Membership Application

Published by the Broker-Dealer & Investment Management Regulation Group  
 September 2011

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..... 2
  - A. SEC Registration ..... 2
  - B. FINRA and Other SRO Membership ..... 3
  - C. State Registration ..... 5
  - D. Time and Expenses ..... 5
- IV. Net Capital and Operations ..... 5
  - A. Net Capital Requirements..... 5
  - B. Interim and Continuing Service Arrangements..... 6
  - C. Clearance and Settlement ..... 6
- Appendix A ..... 8
  - Documents and Fees For Broker-Dealer Registration..... 8
- Appendix B ..... 11
  - Time Line..... 11

## I. Jurisdiction

---

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

---

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 certain 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> 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

---

### 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.

---

<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.

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 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. There is no fee for filing Form BD.

## **B. FINRA and Other SRO Membership**

Application for membership in FINRA requires completion of Form NMA (New Member Application form). Form NMA is organized according to the fourteen individual standards for FINRA membership itemized in NASD Rule 1014.<sup>4</sup> It also lists the forms and supporting documentation required for submission of an application. Certain information is classified as mandatory, including:

- > detailed financial and source of capital information,
- > an organization chart,
- > a completed Form BD,
- > a detailed business plan,<sup>5</sup> and

---

<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.

<sup>4</sup> Prior to the merger of the New York Stock Exchange (“NYSE”) and the National Association of Securities Dealers, Inc. (“NASD”), each entity had its own set of rules. The merged entity, FINRA, is in the process of consolidating the NYSE and NASD rule books. Until the consolidated rule-book is complete, we continue to refer to the original rules as “NASD Rules” and “NYSE Rules,” as applicable.

<sup>5</sup> The business plan must comprehensively describe all material aspects of the business to be conducted upon registration. It must include, 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, and a description of the communications and operational systems employed to conduct business and any business continuity plans.

- > written supervisory policies, procedures and controls.

Applications for membership must also include a FINRA Entitlement Agreement and FINRA Account Administrator Entitlement Form for access to Web CRD. Once the firm is approved for access to Web CRD, it must electronically submit its Forms U-4 (for individual broker registration), any subsequent amendments to its Form BD and any Forms U-5 (broker termination) over Web CRD. 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 U-4), be fingerprinted and pass specified qualifying examinations.

- > 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(f) of the Exchange Act, (2) serve as the broker-dealer's system of supervision as required by NASD Rule 3010 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. NASD Rule 3010 provides that the broker-dealer must have written supervisory procedures reasonably designed to prevent and detect violations of the securities laws and NASD rules.

NASD Rule 1120 requires the continuing education of registered persons associated with the broker-dealer. NASD Rule 1120 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, and to their immediate supervisors. The content of the Firm Element is largely left to the broker-dealer's determination; however, training programs must meet minimum standards and must

---

<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 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.

focus on the particular investment products and services that the broker-dealer offers to customers. The description of 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.

### **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 month 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 appropriate for that business, the number of employees to be registered and the time it takes to obtain the necessary information, including disciplinary information covering the broker-dealer's employees and affiliates. The initial FINRA filing fee is \$5,000 for self clearing broker-dealers and \$3,000 for all other broker-dealers, 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 attached as [Appendix A](#) and a time line for the organization process is attached as [Appendix B](#).

FINRA's evaluation should be expected to take approximately five 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 FINRA and the ability of personnel to take and pass the appropriate registration examinations.

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

---

### **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:

- (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 trades 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

---

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

- (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.

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>9</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 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 may not 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>10</sup>

---

<sup>9</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.

<sup>10</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

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

\* \* \*

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.

---

This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

[www.proskauer.com](http://www.proskauer.com)

© 2011 PROSKAUER ROSE LLP. All Rights Reserved. Attorney Advertising.

Beijing | Boca Raton | Boston | Chicago | Hong Kong | London |  
Los Angeles | New Orleans | New York | Newark | Paris | São Paulo | Washington, DC

---

"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. Form BD Application for the Firm	FINRA application fee is US\$5,000 for full service firms; US\$3,000 for other firms
B. Form NMA	
C. Fingerprint Card for each associated person	US\$30.25 per individual
D. Financial Statement showing the appropriate level of minimum net capital; description of nature and source of capital	
E. Web CRD entitlement request form and New Member Firm Contact Questionnaire	
F. Any waiver requests being submitted to FINRA	
G. New Member Assessment Report	
H. Company check for the total amount of all fees	
I. Business Plan containing:	
1. Experience of principals and persons to be supervised	



Application	
<u>Item</u>	<u>Fees</u>
2. List of all associated persons (with copies of any adverse findings, details of any remedial action imposed on any associated person and written acknowledgement that heightened supervision may be required)	
3. Description of business activities	
4. Representation that adequate facilities, financing and arrangements for conducting business are available	
5. List of securities to be offered and sold and types of retail or institutional customers	
6. Number of markets to be made, if any	
7. Description of how the applicant intends to develop customer base and offer and sell services to customers (internet, phone, seminars, etc.)	
8. Description of facilities and copies of proposed and final lease	
9. Description of communications and operational systems used to conduct business with customers and plans to ensure continuity	
10. Organizational Chart	
11. List of Office Locations	
12. Any plan to enter into contractual commitments, such as underwritings	
13. Any plan to distribute or maintain securities products in proprietary positions	
14. Any other activity that could have a material impact on the Firm's net capital	
J. Fidelity Bond	
K. Evidence of Membership in Lost and Stolen Securities program	

Application	
<u>Item</u>	<u>Fees</u>
L. SIPC registration	
M. Written Compliance and Supervisory Procedures and Controls and internal operating procedures	
N. Training Plan for Continuing Education	
O. State Notices of Registration	
P. Signed statement from accountant that agrees to conduct annual audit	
Q. Trial balance, balance sheet, supporting schedules and capital computations; monthly projection of income and expenses	
R. Banking, clearing and service agreements	
S. FINRA Entitlement Forms	
T. Other Relevant Information	
U. Form U-4 for each individual being registered, amendments to Form BD, and Form U-5 (must be electronically filed once Entitlement Form is approved) (the filing of the Form U-4 also constitutes an application for each examination requested)	US\$95 per individual. (Exam fees are: US\$70 for Series 11; US\$96 for Series 63; US\$105 for Series 24 and 27; and US\$265 for Series 7.)
V. Description of financial controls	
W. Description of proposed recordkeeping system	
X. No Security Sales Activity Statement	
Y. Information regarding expense sharing agreements, if any	
Z. DTC FINS number	

There is a pre-membership interview prior to approval of the application.

### **STATES**

Fees and types of forms necessary for filing at the state level vary from state to state.

## Appendix B

---

### Time Line

Organize the Broker-Dealer Entity (1-3 days)

Prepare and File Form BD with the SEC and Application for Membership in FINRA (generally filed simultaneously) (1-2 months to prepare)

- > Form BD
- > Forms U-4 and Fingerprint Cards for Associated Persons
- > Business Plan, Trial Balance and Proof of Financing
- > Operating Agreements
- > Written Compliance and Supervisory Procedures and Controls
- > Description of Financial Controls
- > Description of Recordkeeping System
- > AML Procedures
- > Disaster Recovery/Contingency Plan
- > Continuing Education Program
- > Fidelity Bond Coverage
- > SIPC Registration

FINRA Evaluation and Request(s) for Additional Information (3-5 months)

FINRA Membership Interview (1 day)

FINRA Approval (1 month)

Total Time: Approximately 6 months from filing

**Note:** Pending approval of the FINRA application, the broker-dealer may not engage in any activities requiring registration 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).