

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * <input type="text" value="24"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - <input type="text" value="2010"/> - * <input type="text" value="056"/> Amendment No. (req. for Amendments *) <input type="text"/>
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Proposed Rule Change by Financial Industry Regulatory Authority  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	<input type="checkbox"/> 19b-4(f)(6)
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**  
Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked \*).

Proposed Rule Change to Adopt FINRA Rule 1113 (Restriction Pertaining to New Member Applications) and to Amend the FINRA Rule 9520 Series (Eligibility Proceedings)

**Contact Information**  
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name * <input type="text" value="Patricia"/>	Last Name * <input type="text" value="Albrecht"/>
Title * <input type="text" value="Assistant General Counsel"/>	
E-mail * <input type="text" value="patricia.albrecht@finra.org"/>	
Telephone * <input type="text" value="(202) 728-8026"/>	Fax <input type="text" value="(202) 728-8264"/>

**Signature**  
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date

By  Senior Vice President and Deputy General Counsel

(Name \*) (Title \*)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

**Form 19b-4 Information (required)**

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change (required)**

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

Add Remove View

Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

Add Remove View

Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

**1. Text of Proposed Rule Change**

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),<sup>1</sup> Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) 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.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

\* \* \* \* \*

**1000. MEMBER APPLICATION AND ASSOCIATED PERSON  
REGISTRATION**

\* \* \* \* \*

**1100. MEMBER APPLICATION**

**1113. Restriction Pertaining to New Member Applications**

The Department of Member Regulation shall reject an application for membership with FINRA pursuant to NASD Rule 1013 in which either the applicant or an associated person, as defined in Article I of the FINRA By-Laws, is subject to a statutory disqualification, as defined in Article III, Section 4 of the FINRA By-Laws. Any such application as described in this Rule that is approved by virtue of Department of Member Regulation error or applicant error (including, but not limited to, an inadvertent or

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

intentional misstatement or omission by the applicant or associated person) shall be subject to cancellation of membership in accordance with Rule 9555.

\* \* \* \* \*

**9000. CODE OF PROCEDURE**

\* \* \* \* \*

**9500. OTHER PROCEEDINGS**

**9520. Eligibility Proceedings**

**9521. Purpose and Definitions**

(a) No Change.

**(b) Definitions**

(1) No Change.

(2) The term “disqualified member” means a [broker, dealer, municipal securities broker or dealer, government securities broker or dealer, or] member that is or becomes subject to a disqualification or is otherwise ineligible for membership under Article III, Section 3 of the FINRA By-Laws.

(3) No Change.

(4) The term “sponsoring member” means the member [or applicant for membership pursuant to NASD Rule 1013] that is sponsoring the association or continued association of a disqualified person to be admitted, readmitted, or permitted to continue in association. A sponsoring member, however, may not sponsor the association or continued association of a disqualified person to be admitted, readmitted, or permitted to continue in association if that disqualified person is directly or indirectly the beneficial owner of more than five percent of the sponsoring member.

**9522. Initiation of Eligibility Proceeding; Member Regulation Consideration**

**(a) Initiation by FINRA**

**(1) Issuance of Notice of Disqualification or Ineligibility**

If FINRA staff has reason to believe that a disqualification exists or that a member or person associated with a member otherwise fails to meet the eligibility requirements of FINRA, FINRA staff shall issue a written notice to the member [or applicant for membership under NASD Rule 1013]. The notice shall specify the grounds for such disqualification or ineligibility. FINRA staff shall not issue such written notice to members [or applicants for membership under NASD Rule 1013] with respect to disqualifications arising solely from findings or orders specified in Section 15(b)(4)(D), (E), or (H) of the Exchange Act or arising under Section 3(a)(39)(E) of the Exchange Act, unless the member [or applicant for membership under NASD Rule 1013] is required to file an application pursuant to a Regulatory Notice entitled “Eligibility Proceedings: Amendments to FINRA Rule 9520 Series to Establish Procedures Applicable to Firms and Associated Persons Subject to Certain Statutory Disqualifications” (the “SD Regulatory Notice”).

(2) No Change.

**(3) Notice Regarding an Associated Person**

A notice issued regarding a disqualified person to a member [or applicant for membership under NASD Rule 1013] shall state that such member [or applicant for membership] may file an application on behalf of itself and such person or, in the case of a matter set forth in Rule 9522(e)(1), a written request for

relief, within ten business days after service of the notice. If the member fails to file the application or, where appropriate, the written request for relief, within the 10-day period, the registration of the disqualified person shall be revoked, unless the Department of Member Regulation grants an extension for good cause shown.

(4) No Change.

**(b) Obligation of Member to Initiate Proceeding**

(1) A member shall file an application or, in the case of a matter set forth in Rule 9522(e)(1), a written request for relief, with RAD, if the member determines prior to receiving a notice under paragraph (a) that:

(A) No Change.

(B) a person associated with such member [or whose association is proposed by an applicant for membership under NASD Rule 1013] has become a disqualified person; or

(C) the member [or applicant for membership under NASD Rule 1013] wishes to sponsor the association of a person who is a disqualified person.

(2) No Change.

(c) through (e) No Change.

**9523. Acceptance of Member Regulation Recommendations and Supervisory Plans by Consent Pursuant to SEA Rule 19h-1**

(a) With respect to all disqualifications, except those arising solely from findings or orders specified in Section 15(b)(4)(D), (E) or (H) of the Exchange Act or arising under Section 3(a)(39)(E) of the Exchange Act, after an application is filed, the

Department of Member Regulation may recommend the [membership or] continued membership of a disqualified member or sponsoring member or the association or continuing association of a disqualified person pursuant to a supervisory plan where the disqualified member, sponsoring member, and/or disqualified person, as the case may be, consent to the recommendation and the imposition of the supervisory plan. The disqualified member, sponsoring member, and/or disqualified person, as the case may be, shall execute a letter consenting to the imposition of the supervisory plan.

(1) through (4) No Change.

(b) With respect to disqualifications arising solely from findings or orders specified in Section 15(b)(4)(D), (E) or (H) of the Exchange Act or arising under Section 3(a)(39)(E) of the Exchange Act, after an application is filed, in approving an application under Rule 9522(e)(2)(F), the Department of Member Regulation is authorized to accept the [membership or] continued membership of a disqualified member or sponsoring member or the association or continuing association of a disqualified person pursuant to a supervisory plan where the disqualified member, sponsoring member, and/or disqualified persons, as the case may be, consent to the imposition of the supervisory plan. The disqualified member, sponsoring member, and/or disqualified person, as the case may be, shall execute a letter consenting to the imposition of the supervisory plan. The Department of Member Regulation shall prepare a proposed Notice under SEA Rule 19h-1, where required, and FINRA shall file such Notice.

(1) through (2) No Change.

\* \* \* \* \*

(b) Not applicable.

(c) Not applicable.

**2. Procedures of the Self-Regulatory Organization**

At its meeting on September 20, 2010, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 90 days following publication of the Regulatory Notice announcing Commission approval.

**3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

(a) Purpose

FINRA is proposing a 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 details of the proposed rule change are described below.

Background

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 disqualification; and that no firm shall be admitted to membership, and no member shall be continued in membership, if any person associated with it is subject to a statutory 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).<sup>2</sup>

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.

#### New Membership Application Rule

FINRA is proposing to adopt new FINRA Rule 1113 providing that the Department of Member Regulation (“Department”) shall reject an application for FINRA

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<sup>2</sup> 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: has been convicted of certain misdemeanor and all felony criminal convictions for a period of ten years from the date of the filing of an application for membership or participation in, or to become associated with a member of, such SRO; is subject to a temporary or permanent injunction (regardless of its age) issued by a court of competent jurisdiction involving a broad range of unlawful investment activities; has been expelled or suspended from membership or participation in an SRO; or is subject to an SEC order denying, suspending, or revoking broker-dealer registration.

membership<sup>3</sup> in which either the applicant or an associated person, as defined in Article I of the FINRA By-Laws,<sup>4</sup> of the applicant is subject to a statutory disqualification, as defined in Article III, Section 4 of the FINRA By-Laws.<sup>5</sup> The proposed rule also provides that any new member application that the Department approves by virtue of 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).

FINRA believes that a new member applicant should enter the membership application process free of the concerns and issues that can arise from either being associated with a disqualified person or being itself subject to a statutory disqualification. Also, a new member applicant has no prior operating or supervisory history, and therefore, cannot demonstrate adequately its ability to supervise a disqualified person.

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<sup>3</sup> Proposed FINRA Rule 1113, by its terms, will 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).

<sup>4</sup> 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”).

<sup>5</sup> 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).

FINRA Rule 9520 Series Amendments

FINRA also is proposing several amendments to the FINRA Rule 9520 Series, which, as noted above, set forth the eligibility proceedings. First, the proposed rule change would amend the FINRA Rule 9520 Series definition of “sponsoring member”<sup>6</sup> to eliminate the reference to new member applicants. As stated above, FINRA is concerned about the ability of new member applicants to supervise adequately a disqualified person, as such applicants generally do not have any prior operating or supervisory history that would indicate the necessary experience to supervise disqualified persons. Thus, this amendment conforms to the proposed new membership application rule discussed above by precluding new member applicants from being able to sponsor disqualified persons.<sup>7</sup>

Second, the proposed rule change would amend the definition of “disqualified member”<sup>8</sup> 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 where the applicant itself is subject to a disqualification.

Lastly, 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 to be admitted, readmitted, or permitted to continue in association that is directly or indirectly a beneficial owner of more than five percent of the sponsoring member. This proposed change reflects FINRA’s belief that a

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<sup>6</sup> FINRA Rule 9521(b)(4).

<sup>7</sup> 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.

<sup>8</sup> FINRA Rule 9521(b)(2).

member cannot effectively supervise such a disqualified person in light of the inherent conflict of interest resulting from the ownership interest. In FINRA's experience, a member's decision to sponsor such a person is nearly always influenced more by that person's beneficial ownership interest in the firm, rather than by objective considerations, such as the person's work experience, the length of time since the disqualifying event, the person's professional activities since the time of the disqualifying event, or subsequent lack of disciplinary history.<sup>9</sup>

FINRA notes that the proposed rule change is not designed to apply in several situations. Proposed new FINRA Rule 1113 would not apply to a new member applicant that itself is subject to a statutory disqualification solely due to its association with a non-natural person that is subject to a statutory disqualification.<sup>10</sup> Also, in such situations, notwithstanding the proposed rule change to the FINRA Rule 9520 Series that would preclude a new member applicant from submitting an application for relief under the FINRA Rule 9520 Series, the new member applicant would be permitted to file an MC-400A application on behalf of itself.

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<sup>9</sup> [See \*The Ass'n of X as a Gen. Secs. Representative, Chairman, CEO, and owner, Redacted Decision No. SD99013 \(NASD NAC 1999\)\*](#) at 9 (the National Adjudicatory Council denied a sponsoring firm's statutory disqualification application, finding that the proposed supervisor would not adequately supervise a disqualified individual who would be 100 percent owner of the firm).

<sup>10</sup> Exchange Act Section 3(a)(39)(E) subjects a person to a statutory disqualification if the person is associated with any person who is known, or in the exercise of reasonable care should be known, by him to be subject to any statutory disqualification described in Exchange Act Sections 3(a)(39)(A) through (D). Because the applicable definition of "associated person" (set forth in Exchange Act Section 3(a)(21)) includes non-natural persons, a member may find itself subject to a statutory disqualification solely because it is associated with a person who is subject to a statutory disqualification pursuant to Exchange Act Section 3(a)(39)(A) through (D). For additional information, [see Regulatory Notice 09-19](#) (April 2009).

Moreover, the proposed amendments to the FINRA Rule 9520 Series that would preclude any member from sponsoring a disqualified person that is directly or indirectly a beneficial owner of more than five percent of the sponsoring member would not preclude a member from filing an MC-400A application to sponsor itself where needed (e.g., a member whose majority owner is subject to a 30-day principal suspension for failure to supervise a books and records violation may seek to sponsor itself for continued membership rather than having to cease business for the period of its owner's suspension).

As noted in Item 2 of this filing, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 90 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>11</sup> which requires, among other things, that FINRA rules must 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 interest. The proposed rule change will further these purposes by restricting certain members and new member applicants from being able to associate with statutorily disqualified persons in light of the concerns to investor protection raised by such associations.

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<sup>11</sup> 15 U.S.C. 78q-3(b)(6).

**4. Self-Regulatory Organization’s Statement on Burden on Competition**

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

**5. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

Written comments were neither solicited nor received.

**6. Extension of Time Period for Commission Action**

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.<sup>12</sup>

**7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

Not applicable.

**8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

Not applicable.

**9. Exhibits**

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

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<sup>12</sup> 15 U.S.C. 78s(b)(2).

EXHIBIT 1

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

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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on , Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing 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 text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA is proposing a 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 details of the proposed rule change are described below.

Background

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 disqualification; and that no firm shall be admitted to membership, and no member shall be continued in membership, if any person associated with it is subject to a statutory 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).<sup>3</sup>

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.

#### New Membership Application Rule

FINRA is proposing to adopt new FINRA Rule 1113 providing that the Department of Member Regulation (“Department”) shall reject an application for FINRA

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<sup>3</sup> 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: has been convicted of certain misdemeanor and all felony criminal convictions for a period of ten years from the date of the filing of an application for membership or participation in, or to become associated with a member of, such SRO; is subject to a temporary or permanent injunction (regardless of its age) issued by a court of competent jurisdiction involving a broad range of unlawful investment activities; has been expelled or suspended from membership or participation in an SRO; or is subject to an SEC order denying, suspending, or revoking broker-dealer registration.

membership<sup>4</sup> in which either the applicant or an associated person, as defined in Article I of the FINRA By-Laws,<sup>5</sup> of the applicant is subject to a statutory disqualification, as defined in Article III, Section 4 of the FINRA By-Laws.<sup>6</sup> The proposed rule also provides that any new member application that the Department approves by virtue of 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).

FINRA believes that a new member applicant should enter the membership application process free of the concerns and issues that can arise from either being associated with a disqualified person or being itself subject to a statutory disqualification. Also, a new member applicant has no prior operating or supervisory history, and therefore, cannot demonstrate adequately its ability to supervise a disqualified person.

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<sup>4</sup> Proposed FINRA Rule 1113, by its terms, will 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).

<sup>5</sup> 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”).

<sup>6</sup> 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).

FINRA Rule 9520 Series Amendments

FINRA also is proposing several amendments to the FINRA Rule 9520 Series, which, as noted above, set forth the eligibility proceedings. First, the proposed rule change would amend the FINRA Rule 9520 Series definition of “sponsoring member”<sup>7</sup> to eliminate the reference to new member applicants. As stated above, FINRA is concerned about the ability of new member applicants to supervise adequately a disqualified person, as such applicants generally do not have any prior operating or supervisory history that would indicate the necessary experience to supervise disqualified persons. Thus, this amendment conforms to the proposed new membership application rule discussed above by precluding new member applicants from being able to sponsor disqualified persons.<sup>8</sup>

Second, the proposed rule change would amend the definition of “disqualified member”<sup>9</sup> 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 where the applicant itself is subject to a disqualification.

Lastly, 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 to be admitted, readmitted, or permitted to continue in association that is directly or indirectly a beneficial owner of more than five percent of the sponsoring member. This proposed change reflects FINRA’s belief that a

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<sup>7</sup> FINRA Rule 9521(b)(4).

<sup>8</sup> 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.

<sup>9</sup> FINRA Rule 9521(b)(2).

member cannot effectively supervise such a disqualified person in light of the inherent conflict of interest resulting from the ownership interest. In FINRA's experience, a member's decision to sponsor such a person is nearly always influenced more by that person's beneficial ownership interest in the firm, rather than by objective considerations, such as the person's work experience, the length of time since the disqualifying event, the person's professional activities since the time of the disqualifying event, or subsequent lack of disciplinary history.<sup>10</sup>

FINRA notes that the proposed rule change is not designed to apply in several situations. Proposed new FINRA Rule 1113 would not apply to a new member applicant that itself is subject to a statutory disqualification solely due to its association with a non-natural person that is subject to a statutory disqualification.<sup>11</sup> Also, in such situations, notwithstanding the proposed rule change to the FINRA Rule 9520 Series that would preclude a new member applicant from submitting an application for relief under the FINRA Rule 9520 Series, the new member applicant would be permitted to file an MC-400A application on behalf of itself.

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<sup>10</sup> [See The Ass'n of X as a Gen. Secs. Representative, Chairman, CEO, and owner, Redacted Decision No. SD99013 \(NASD NAC 1999\)](#) at 9 (the National Adjudicatory Council denied a sponsoring firm's statutory disqualification application, finding that the proposed supervisor would not adequately supervise a disqualified individual who would be 100 percent owner of the firm).

<sup>11</sup> Exchange Act Section 3(a)(39)(E) subjects a person to a statutory disqualification if the person is associated with any person who is known, or in the exercise of reasonable care should be known, by him to be subject to any statutory disqualification described in Exchange Act Sections 3(a)(39)(A) through (D). Because the applicable definition of "associated person" (set forth in Exchange Act Section 3(a)(21)) includes non-natural persons, a member may find itself subject to a statutory disqualification solely because it is associated with a person who is subject to a statutory disqualification pursuant to Exchange Act Section 3(a)(39)(A) through (D). For additional information, [see Regulatory Notice 09-19 \(April 2009\)](#).

Moreover, the proposed amendments to the FINRA Rule 9520 Series that would preclude any member from sponsoring a disqualified person that is directly or indirectly a beneficial owner of more than five percent of the sponsoring member would not preclude a member from filing an MC-400A application to sponsor itself where needed (e.g., a member whose majority owner is subject to a 30-day principal suspension for failure to supervise a books and records violation may seek to sponsor itself for continued membership rather than having to cease business for the period of its owner's suspension).

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 90 days following publication of the Regulatory Notice announcing Commission approval.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>12</sup> which requires, among other things, that FINRA rules must 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 interest. The proposed rule change will further these purposes by restricting certain members and new member applicants from being able to associate with statutorily disqualified persons in light of the concerns to investor protection raised by such associations.

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<sup>12</sup> 15 U.S.C. 78q-3(b)(6).

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form

(<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2010-056 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2010-056. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2010-056 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Florence E. Harmon

Deputy Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).