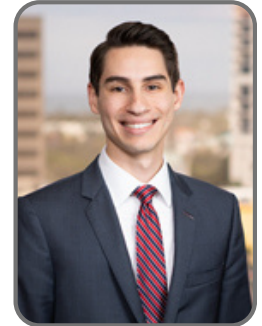


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SEC Requires FINRA Membership for Previously Exempt Broker-Dealers



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The Securities and Exchange Commission (SEC) has recently proposed (July 29, 2023) and rapidly adopted (August 23, 2023) amendments to SEC Rule 15b9-1 that will essentially require almost all broker-dealers to become registered members of the Financial Industry Regulatory Authority (FINRA).

While broker-dealers are generally required to maintain FINRA membership, some exceptions exist pursuant to SEC Rule 15b9-1. Up until the recent adoption of the amendments, the Rule permitted a broker-dealer to avoid FINRA membership if the broker-dealer: (1) was a member of a national securities exchange, (2) carried no customer accounts, and (3) used another broker-dealer to conduct any proprietary trading off an exchange where it is a member.

The adopted amendments remove the third element above, often referred to as the “proprietary trading exclusion,” and replace it with two narrow exceptions that apply to off-member-exchange securities transactions that either (a) result solely from orders that are routed by a national securities exchange to comply with order protection regulatory requirements, or (b) are solely for purposes of executing the stock leg of a stock-option order.

Although there are not many broker-dealers that have avoided FINRA membership—and its jurisdiction—to this point, most will now be required to obtain FINRA membership. The compliance date will be 365 days after publication in the Federal Register.

In its adopting release, the SEC refers to “FINRA’s ability to create a consistent regulatory framework” and asserts that “it is appropriate for FINRA to have direct membership-based jurisdiction.” It therefore appears that the SEC is pushing for a more uniform registration of broker-dealers in an attempt to avoid varied oversight or recourse by separate exchanges with different rules or rule interpretations, which previously presented potential for inconsistent outcomes, whereas FINRA can enforce a consistent approach.

Accordingly, the adoption of these amendments means big changes for proprietary trading firms, which will now be subject not only to the fees and costs associated with FINRA membership, but also to additional obligations such as reporting their trades in U.S. Treasury securities to FINRA’s fixed-income reporting system, the Trade Reporting and Compliance Engine.

Shumaker’s experienced financial industry attorneys have assisted broker-dealers with hundreds of SEC and FINRA compliance issues. A comprehensive outline of the FINRA membership application process (and required documentation) is available upon request. Contact Justin Senior for more information.

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