

Transitioning To an Independent Broker-Dealer: Key Considerations

Cover Your Legal Bases

Make sure you meet your obligations to your clients, former employer, new broker-dealer, and the regulators.

- Speak with legal counsel to review employment agreements, restrictive covenants, and receive guidance on the overall transition process
- Choose a name for the broker-dealer and register your trade name in your state of domicile. FINRA must also approve your name selection
- Decide how the broker-dealer is to be structured — LLC, Corporation, LLP, etc.
- Form the entity with the state and obtain TIN (taxpayer identification number) from the IRS
- Open a bank account for the broker-dealer, and deposit enough funds to cover upfront expenses, any professional fees, clearing deposits, and 12 months of fixed expenses
- File a membership application with FINRA and a registration request with the state of domicile. This is the most time-consuming and complex step. Luckily, you can outsource this task to professionals
- Once the application is filed, the principals must complete appropriate exams, if required
- After FINRA and the SEC approve the firm, it may also need to register in each state in which it will do business

Communicate, Communicate, Communicate

Take charge of communications. If you're the one to initiate the conversation, you can control the message.

- Start the resignation process by informing management; don't let a nasty surprise spoil relationships
- Address your impending move with clients. Stay positive, answer their questions, and, if your agreements allow you to keep existing relationships, explain how your move benefits them
- Leave with style: send out a professional announcement to your clients on your day of departure

Get Ready To Open For Business

Now it's up to you to make sure your practice is ready to go.

- Create a marketing and business plan; now, you're the one responsible for growth
- Locate office space and order office equipment (computers, furniture, phone lines, etc.)
- Order your business cards and letterhead, and set up your email address and phone number
- Create a web site—your clients expect one

Contact a senior Pershing associate to discuss your business model recommendation and gain objective information about firms who support your recommended business model.

The Top Myths on Establishing a Broker-Dealer

➤ **It is easy to start a broker-dealer.**

False. Starting a broker-dealer can be a painful and arduous process. Registration can take four to six months. FINRA has only recently rolled out its electronic version of the Centralized New Member Application. Many new broker-dealer start-ups elect to use a service bureau or a specialty law firm to assist them with the application.

➤ **You have to employ many people to be in business as a broker-dealer.**

False. There are approximately 4,594 firms, representing 91.8% of the total firms registered with FINRA, which employ 150 people or less. Many registered broker-dealers have only one employee. Outsourcing is a great alternative for “small shops.”

➤ **There are few regulatory requirements for a broker-dealer.**

False. There are a great many regulatory requirements a broker-dealer must adhere to, including supervision activities, anti-money laundering (AML) programs, advertising, and processing customer complaints. And the regulatory landscape is always in flux.

➤ **Starting a broker-dealer requires little more than some additional training and education.**

False. Most firms must have at least two Supervisory Principals who have passed their Series 7 and 24 exams (there are some exceptions, but your firm would have to obtain a special waiver). Additionally, your firm is required to have a Financial and Operations Principal. If your firm will handle products like municipal bonds or options, then your firm will also be required to have a Municipal Options Principal. And you must have sufficient capital for the risks associated with your business lines.

➤ **I do not need supervisory experience to start a broker-dealer.**

False. In addition to having two Supervisory Principals and a Financial and Operations Principal, FINRA requires that anyone in a supervisory role has at least one year of direct supervisory experience, or at least two years of indirect experience.

➤ **I have to be a “big name” to be a broker-dealer.**

False. Many brokers follow the “small shop” model, providing hands-on service to their customers while enjoying the benefit of higher commission payouts.

➤ **I am not responsible for Anti-Money Laundering (AML) if I have a written arrangement with my clearing firm.**

False. While your clearing firm has the initial responsibility of accepting a new account opening and processing the paper trail, your firm still remains responsible for your AML program, even though you have outsourced these functions. To identify red flags and potential money laundering concerns, pay close attention to the exception reports you receive and maintain ongoing communication with your clearing firm.

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Source: Regulatory Compliance