SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 76307 / October 29, 2015

Admin. Proc. File No. 3-16262

In the Matter of the Application of

BERING STRAIT SECURITIES, INC.

For Review of Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DENIAL OF MEMBERSHIP APPLICATION

Registered securities association denied application for membership on the ground that firm failed to demonstrate that it meets the association's standards for membership. *Held*, the review proceeding is *dismissed*.

APPEARANCES:

Maria M. Ermolova, for Bering Strait Securities, Inc.

Alan Lawhead, *Michael Garawski*, and *Colleen Durbin*, for the Financial Industry Regulatory Authority, Inc.

Appeal filed: November 6, 2014
Last brief received: February 26, 2015

Bering Strait Securities, Inc. ("Bering Strait" or the "Firm") appeals from a FINRA decision denying its new membership application (including all attachments and amendments, the "Application"). FINRA found that the Firm did not satisfy FINRA Rule 1014(a) standards for membership because it: (i) failed to demonstrate that it is capable of maintaining adequate net capital to support its intended business operations on a continuing basis; (ii) has not established financial controls to ensure compliance with federal securities laws, rules, and regulations and NASD rules; and (iii) does not have a supervisory system designed to prevent and detect, to the extent practicable, violations of the federal securities laws, rules, and regulations, and NASD rules. On appeal, Bering Strait contends that the Application satisfied each membership standard; that FINRA misapplied its rules; and that the decision was unfair. Based on an independent review of the record, we conclude that FINRA properly exercised its discretion, relied on grounds that exist in fact, and denied the Application in accordance with FINRA rules, which are and were applied in a manner that is consistent with the purposes of the Securities Exchange Act of 1934. We therefore dismiss this appeal.

I. Background

A. FINRA by-laws and rules govern its membership application process.

FINRA evaluates applications for membership pursuant to Article III, Section 2 of its By-laws. The By-laws authorize FINRA to set "financial responsibility and operational capability" standards for membership; to consider the "nature, extent, and type" of the applicant's proposed securities business; and to apply those standards as "necessary or desirable" in its discretion.[1] Under Rule 1014(a), FINRA's Department of Member Regulation ("Member Regulation") evaluates new member applications based on fourteen membership standards and in light of "the public interest and the protection of investors."[2] The applicant firm bears the burden of demonstrating that it satisfies each standard and that its membership is in the public interest.[3] An applicant may appeal a membership denial to FINRA's National Adjudicatory Council ("NAC").[4]

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[1] FINRA's standards and procedures for reviewing membership applications are set forth in the NASD Rule 1010 series, and every firm seeking to sell securities to the public in the United States must be registered by FINRA. *See generally* http://www.finra.org/industry/member-regulation (last visited Sept 17, 2015).

[2] Member Regulation may approve, deny, or grant membership subject to business restrictions. FINRA Rule 1014(b).

[3] *Asensio & Co., Inc.*, Exchange Act Release No. 68505, 2012 WL 6642666, at *4 (Dec. 20, 2012); *Grand Sec. Co.*, Exchange Act Release No. 31133, 1992 WL 224081, at *3 (Sept. 2, 1992).

[4] The NAC decision becomes FINRA's final decision unless it is called for review by the FINRA Board. FINRA Rule 1015(j)(3).

B. Bering Strait applied for FINRA membership based on Ermolova's background in the securities industry.

Bering Strait is wholly owned and operated by Maria M. Ermolova. Ermolova has an M.B.A from Hofstra University, a Master's Degree in Finance from Vanderbilt University, and approximately two years of securities industry experience. She worked for one year and ten months (from August 2011 to May 2013) at Mid-Market Securities, LLC, where, in 2012, she earned $6,011 as a senior investment banking associate. Ermolova also worked for two months (from January 2011 to March 2011) as an investment banking analyst at National Securities Corporation, and for eight months (from January 2010 to August 2010) as a part-time investment banking intern at Palladium Capital Advisors, LLC.[5]

On August 12, 2013, Bering Strait applied for FINRA membership. In its Application, Bering Strait described its plans to serve as a managing underwriter or selling group participant for public and private securities offerings and to provide investment banking services for mergers and acquisitions (M&A) in various countries and industries. The Application included a balance sheet and approximately one year of income and expense projections. It forecasted revenue of $856,043.

The Application indicated that Ermolova would serve as the Firm's sole proprietor and Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Financial and Operational Principal (FINOP), Chief Compliance Officer (CCO), and Anti-Money Laundering Compliance Officer (AMLCO).[6] The Firm also stated that Ermolova might supervise up to two independent contractors during its first year of operation.

If approved as a member firm, Bering Strait would have to maintain $5,000 in net capital pursuant to Exchange Act Rule 15c3-1, and $6,000 in net capital to avoid triggering an early warning requirement pursuant to Exchange Act Rule 17a-11(c)(3).[7] In its Application, the Firm stated that it had $7,580 in net capital. It generated this amount from cash advances from the Firm's credit cards and Ermolova's prepaid and personal credit cards. The Firm represented that, once operating, it would maintain the requisite net capital and cover its operating expenses through business and personal credit cards, as well as through income generated from Ermolova's part-time, non-securities related employment and a possible loan from Ermolova's

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[5] The NAC found that Ermolova earned a total of approximately $8,500 during her several years of employment in the securities industry. Ermolova does not dispute this finding.

[6] Upon filing the Application, Ermolova possessed the following licenses: Series 24 (General Securities Principal); Series 79 (Limited Representative-Investment Banker); Series 28 (Introducing Broker/Dealer Financial and Operations Principal). After Member Regulation denied the Application, Ermolova obtained her Series 7 license (General Securities Representative).

[7] 17 C.F.R. § 240.15c3-1; 17 C.F.R. § 240.17a-11(c)(3). *See First Heritage Inv. Co.*, Exchange Act Release No. 33484, 1994 WL 17098, at *4 (Jan. 14, 1994) (noting the "primary purpose" of the notice provision is to "protect customers and creditors of registered broker-dealers from monetary losses and delays that can occur when a registered broker-dealer fails").

father. Bering Strait submitted statements showing available credit on the cards and described Ermolova's prospects for part-time work as, among other things, a language translator, instructor, and massage therapist.

C. Member Regulation denied Bering Strait's Application.

Between August 27, 2013 and December 30, 2013, Member Regulation reviewed the Application, conducted a preliminary interview, and asked for additional information about, among other things: the sources of the Firm's capital, Ermolova's search for part-time work, and the Firm's claim that it might secure additional funding from friends and family. Member Regulation also sought more information about Ermolova's investment banking experience and contacts, as well as her experience in compliance and financial operations. On January 28, 2014, Member Regulation conducted a membership interview that focused on the Firm's net capital and Ermolova's experience to serve as FINOP, CCO/AMLCO, and sole supervisor.

On February 18, 2014, Member Regulation denied the Application, finding that the Firm failed to satisfy seven membership standards, including the net capital, financial controls, and supervisory structure standards. Six days later, Bering Strait appealed to the NAC.

D. The NAC denied Bering Strait's Application.

On April 29, 2014, a NAC subcommittee held a hearing. Ermolova represented and testified for Bering Strait. Member Regulation offered testimony from two members of its Membership Application Program.[8] All of the proposed exhibits were admitted into the record.

On October 2, 2014, the NAC affirmed Member Regulation's denial of the Application. First, the NAC found that the Firm failed to demonstrate its ability to maintain sufficient net capital to support its intended operations on a continuing basis. It found that the Firm's reliance on credit cards, part-time outside employment, and family loans "demonstrates a lack of . . . financial wherewithal." The NAC also determined that the Firm failed to identify specific investment banking prospects or demonstrate the industry relationships required to sustain the proposed business and meet its net capital requirements.

Next, the NAC found that the Firm failed to demonstrate adequate financial controls. The NAC concluded that errors in the Firm's financial statements and net capital calculation raised "significant red flags" about its ability to comply with U.S. Generally Accepted Accounting Principles ("GAAP"). The NAC found that the Firm submitted financial information that failed to properly classify recurring expenses, including a balance sheet that underestimated total liabilities by omitting office rent expenses and financial projections that failed to accrue for

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[8] The NAC found that a portion of Member Regulation's testimony "advanc[ed] new grounds" for denial by introducing evidence on a specific investment banking deal, a telephone conversation with Ermolova's former supervisor, and an analysis of the Firm's capital transfers. The NAC concluded that addressing this testimony on appeal could raise "notice or fairness issues," and did not rely on the testimony in its decision.

tax expenses.[9] The NAC further concluded that the Firm's net capital calculation did not include line items required under Exchange Act Rule 15c3-1, did not satisfy GAAP, and, when correctly calculated, fell below the Exchange Act Rule 17a-11 early warning level.

Finally, the NAC found that Ermolova lacked sufficient preparation to be the Firm's FINOP, CCO/AMLCO, and sole supervisor. The NAC found that Ermolova's hearing testimony and the errors in the Firm's Application demonstrated a "lack of understanding" and preparation for such responsibilities. The NAC expressed particular concern that "Ermolova was unaware that net capital should be calculated pursuant to" GAAP. The NAC assessed Ermolova's claims about her experience in light of her approximately $6,000 in annual compensation at Mid-Market Securities, and concluded that she either "mischaracteriz[ed]" her role or "exaggerat[ed]" her experience and that her claims about that experience were "unreliable." The NAC concluded that granting Bering Strait's Application would "pose[] a risk to the investing public, the securities markets, other member firms and Bering Strait itself," given the risks of investment banking, Ermolova's limited experience, and the lack of "checks and balances" involved in the sole proprietorship. On this basis, FINRA denied Bering Strait's membership application. This appeal followed.

II. Analysis

A. Standard of Review

Section 19(f) of the Exchange Act governs our review of FINRA's denial of an application for membership.[10] The applicant firm bears the burden of demonstrating that it satisfies the membership standards and that its membership is in the public interest, and FINRA has discretion in applying and interpreting its membership rules.[11] We must dismiss Bering

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[9] The NAC also found that the Firm's financial projections incorrectly classified cashback rewards from credit cards as Firm revenue. The Firm argues that it was improper for the NAC to consider this purported revenue source because Member Regulation did not raise the issue during the membership interview or in the letter explaining its decision. But as discussed in Section II.C. below, the Firm had notice of this issue, which falls within the broader concern identified by FINRA that the Firm's financial controls would not ensure compliance with applicable reporting requirements. The Firm also asserts on appeal that the classification as revenue was appropriate and that it was not required to comply with GAAP, but offers no authority supporting these assertions.

[10] 15 U.S.C. § 78s(f).

[11] *See Exchange Services, Inc.*, Exchange Act Release No. 22245, 1985 WL 548404, at *3 & n.10 (July 10, 1985) (explaining that the Commission "will not substitute our judgment for that of the" SRO in reviewing a decision under § 19(f)), *aff'd*, 797 F.2d 188 (4th Cir. 1986); *Nicholas S. Savva*, Exchange Act Release No. 72485, 2014 WL 2887272, at *14 (June 26, 2014) (noting the discretion afforded to FINRA under § 19(f) when applying its statutory disqualification rules); *Revcon, Inc.*, Exchange Act Release No. 39298, 1997 WL 685314, at *4 (Nov. 5, 1997) (finding that an applicant firm's agreement to comply with conditions for

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Strait's appeal of FINRA's membership denial if we find that: (i) the specific grounds on which FINRA based its denial exist in fact; (ii) the denial was in accordance with FINRA's rules; and (iii) FINRA's rules are, and were applied in a manner, consistent with the Exchange Act's purposes.[12] FINRA's decision satisfies these criteria.[13]

B. The grounds for FINRA's denial of membership exist in fact.

FINRA's findings regarding Bering Strait's net capital, financial controls, and supervisory structure exist in fact. Bering Strait does not contest these facts, which are based on the Firm's Application materials, but instead questions FINRA's analysis of the facts and interpretation of the membership standards.

1. *The Application failed to demonstrate that Bering Strait is capable of maintaining sufficient net capital under Rule 1014(a)(7).*

FINRA Rule 1014(a)(7) requires an applicant firm to demonstrate its ability to exceed the minimum net capital requirements in Exchange Act Rule 15c3-1 and support its "intended business operations on a continuing basis." FINRA's new member application requires each applicant to calculate its net capital and describe the nature and source of its future capital. It is undisputed that the Firm proposes to rely on unsecured lines of credit, personal loans, and part-time outside work to meet these requirements. We agree with FINRA that these sources of funding do not demonstrate the Firm's ability to exceed the minimum net capital requirements. We also agree that part-time work by Ermolova to meet the net capital requirements and cover operating expenses could detract from her ability to operate the proposed business and that the Firm's funding plans generally expose it to "serious financial complications." Liquidity is the "paramount concern of the net capital rule," which is designed to ensure that member firms continuously maintain sufficient liquid assets to promptly satisfy their liabilities and cover other operational risks.[14] Credit cards, prospective part-time income of the sole proprietor, and

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(…continued)

membership with The Options Clearing Corporation did not satisfy the firm's burden when it "in fact never adequately demonstrated such compliance").

12 15 U.S.C. § 78s(f).

13 Exchange Act Section 19(f) also requires us to set aside FINRA's action if we find that the action imposes an undue burden on competition. 15 U.S.C. § 78s(f). Bering Strait does not claim, nor does the record support a finding, that FINRA's denial imposes such a burden.

14 *Kirk L. Ferguson*, Exchange Act Release No. 34621, 1994 WL 482332, at *2 (Aug. 31, 1994); *Lowell H. Listrom*, Exchange Act Release No. 30497, 1992 WL 58904, at *3 (Mar. 19, 1992) ("The primary purpose of [the net capital rule] is to ensure that broker-dealers have sufficient liquid capital to protect the assets of customers and to meet their responsibilities to other broker-dealers."), *aff'd*, 975 F.2d 866 (8th Cir. 1992); *Wallace G. Conley*, Exchange Act Release No. 31913, 1993 WL 62525, at *3 (Feb. 24, 1993) (noting the importance of "liquid assets" and that failure to comply with net capital requirements "subject[s] the firm's customers to undue risks").

possible loans from family are not liquid assets for purposes of this net capital calculation.[15] We find that Bering Strait failed to demonstrate that its proposed funding sources would enable the Firm to maintain the $5,000 minimum net capital required under Rule 15c3-1.

Bering Strait argues that its proposed sources of funding should count toward its capitalization requirement because they are not specifically prohibited. Although Rule 1014(a)(7) does not expressly prohibit particular types of capital, it incorporates the net capital calculation required under Rule 15c3-1, which counts liquid assets toward the Firm's net capital. Bering Strait does not claim that any of its proposed funding sources are liquid assets that count towards the Firm's net capital calculation under Rule 15c3-1.

Bering Strait asserts that income from Ermolova's part-time work is the "main planned source" to cover the Firm's operating expenses and pay off credit card debt and interest. But the Firm argues that it is improper for FINRA to consider how such part-time work would affect the Firm's operations or ability to meet its net capital requirements. To the contrary, FINRA reasonably assessed all of the facts and circumstances to assess the adequacy of the Firm's plans to meet its capital requirements.[16] In this case, FINRA reasonably concluded that it could not "ignore the financial realities" of relying on capitalization sources "that may not actually be available." FINRA noted that the Firm ultimately could be required to rely on this credit "for longer than or to a greater extent than anticipated" particularly because it had "not identified any specific prospective issuers or investors" to generate revenue.

Bering Strait claims that it was improper for FINRA to consider the Firm's proposed capitalization "for the first 12 months" of the Firm's operations. But Rule 1014(a)(7) expressly requires the firm to demonstrate that, if approved for membership, it would be able to support its "intended business operations on a continuing basis" without reducing its capitalization below the requisite level. Because neither the credit card nor part-time income were liquid assets and Ermolova stated that she would cover Firm expenses and credit card debt during the first twelve months of the Firm's operation, FINRA appropriately considered how Ermolova's part-time work

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[15] Liquid assets are cash or "assets that can be readily converted into cash." *Broker Dealer Exemption from Sending Certain Fin. Info. to Customers*, Exchange Act Release No. 46920, 2002 WL 31664446, at **1 n.3, 4 (Nov. 26, 2002); *see also Ferguson*, 1994 WL 482332, at *2 (finding that liquid assets did not include an cashier's check because it was not deposited into the firm's account or an unguaranteed promissory note drawn against a personal line of credit).

[16] *Grand Sec. Co.*, 1992 WL 224081, at *2 n.9 ("Even if a firm demonstrates that it has sufficient assets to meet the minimum requirements of Rule 15c3-1, it would not automatically satisfy the NASD's requirements regarding the adequacy, source and permanence of capital. Such a determination must be made on the basis of all factors, including the specific activity contemplated by the firm."); *see also* Membership Application Proceedings, FINRA Regulatory Notice 10-01, at 3 (Jan. 2010), *available at* https://www.finra.org/industry/notices/10-01 (last checked Sept. 17, 2015) (explaining that the membership application process "is a fluid probing exercise that seeks to evaluate all relevant facts and circumstances regarding each applicant" and its "ultimate goal is to ensure that each applicant is capable of conducting its business in compliance with applicable rules and regulations").

would affect the Firm's proposed future operations as a sole proprietorship. FINRA reasonably concluded that it could not "reconcile the amount of time Ermolova has dedicated, and will dedicate to Bering Strait with working at a part-time job enough hours to support her business and living expenses."

Bering Strait claims that the Firm would have sufficient credit and income from part-time work to meet the Firm's net capital requirements and expenses during its first year of operations. In support of this claim, the Firm attaches credit card and bank statements to its reply brief purporting to show an increase in the credit available to the Firm and that Ermolova earned part-time income during the previous twelve months. We do not consider these attachments to the reply brief in evaluating FINRA's membership denial. Under Commission Rule of Practice 452, a party who wishes to introduce additional evidence must file a motion and "show with particularity that such additional evidence is material and that there were reasonable grounds for failing to adduce such evidence previously." Bering Strait has not filed such a motion and has not established that the evidence it seeks to adduce is material.[17] FINRA's findings were based on the illiquidity—not the amounts—of the Firm's funding sources and the statements attached to the reply brief would not counteract those findings. For instance, any increase in available credit is beside the point for FINRA's net capital findings because, as FINRA observed, the amount of available credit had "no bearing on its decision" and "personal, unsecured credit" of this sort "could disappear or decrease" despite Ermolova's best efforts.

Nor are the bank statements purporting to show Ermolova's part-time income material, because the Firm has submitted bank statements from Ermolova's personal accounts that do not count toward the Firm's net capital. Nor do the bank statements show that any deposits were generated from part-time work, offer any assurance of the amount of future income, or indicate that such part-time income would be sufficient to cover the Firm's operating expenses. In fact, each personal account shows a most recent balance of less than $50 and the Firm has submitted a Bering Strait account statement showing a balance that had increased by $10 (to $7590). Ermolova argues that this evidence demonstrates her determination and the sincerity of her desire to establish her own broker-dealer. But FINRA's findings regarding the Firm's net capital were not based on questions about Ermolova's sincerity or determination. FINRA noted Ermolova's testimony that "she would not let the firm fall below net capital nor would she default on any of her credit cards" and stated: "While we take Ermolova at her word, we cannot ignore the financial realities surrounding the precarious nature of [the Firm's] capitalization." We agree with FINRA that, despite Ermolova's sincerity, Bering Strait has failed to show that it is capable of maintaining sufficient net capital.

The Firm's remaining arguments are similarly unavailing. Bering Strait argues that its future expenses will be minimal, that its business model is "almost risk free," and that the business can be run from the homes of its employees and will not result in any customer or broker liabilities. The Firm has offered no evidence to substantiate these claims, which, even if

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[17] *See Asensio & Co.*, 2012 WL 6642666, at *15 (declining to adduce evidence that was not material to the new member application at issue in the proceeding).

true, are not relevant to FINRA's determination that the Firm failed to demonstrate that it could maintain the required minimum net capital while operating the business on a continuing basis.

2. *The Firm failed to demonstrate adequate financial controls under FINRA Rule 1014(a)(8).*

FINRA Rule 1014(a)(8) requires the applicant firm to demonstrate that it has "financial controls to ensure compliance with the federal securities laws, the rules and regulations thereunder, and [FINRA] Rules." The financial controls should ensure that the applicant submits to FINRA financial information that properly accrues liabilities and complies with GAAP and with the net capital computation requirements of Exchange Act Rule 15c3-1.[18] The applicant also must demonstrate that it is able to establish contingencies for funding its net capital and to identify and control risks to such funding.[19] FINRA found that the Firm's balance sheet, financial projections, net capital computations, and proposed financial management failed to show the requisite financial controls. FINRA found that the financial control weaknesses resulted in multiple errors in the Firm's classification and recognition of asset and liabilities in financial reports, projections, and calculations, each of which cast doubt on the Firm's ability to comply with GAAP and Exchange Act reporting rules, and to appropriately plan and track operating expenses.

FINRA found, and we agree, that errors in the Firm's balance sheet and financial projections are evidence of inadequate financial controls. The Firm failed to recognize monthly office rent expense on the balance sheet. The Firm argues that it was not required to include rent on its balance sheet because the lease operated on a month-to-month basis. But the Application (including its projections) indicated that the Firm expected to run its business from rented office space, and its reply brief confirms its plans to do so unless "an emergency situation arises." The Firm also failed to account for tax accruals in its financial projections. The Firm argues that it was proper to exclude tax expenses because FINRA did not "provide a template or list of categories required for projections," and did not otherwise require it to calculate the net tax amount that would be included on the projections. But the Firm submitted multiple projections covering March 2013 through January 2015, each of which included a separate line item for taxes without including tax expenses for any of those periods. In any case, the Firm's failures to classify and account for standard operating expenses, including office rent and taxes, are directly relevant to whether its financial controls will ensure compliance with its reporting and other responsibilities under the federal securities laws and FINRA rules.

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[18] *North Woodward Fin. Corp.*, Exchange Act Release No. 60505, 2009 WL 2488066, at *4 & nn.16 & 18 (Aug. 14, 2009) (finding that a broker-dealer's records were non-compliant because they were not kept on an accrual basis and did not classify transactions according to GAAP); *Joseph S. Barbera*, Exchange Act Release No. 43528, 2000 WL 1671434, at *1 (Nov. 7, 2007) (explaining that the Commission requires broker-dealers to keep their books in accordance with GAAP and to use accrual accounting for recognizing revenue and liabilities).

[19] *See* FINRA Internal and Financial Control Policies and Procedures Checklist, *available at* http://www.finra.org/file/internal-and-financial-control-policies-and-procedures-chklstdoc (last checked Sept. 17, 2015).

FINRA also reasonably concluded that the Firm's net capital calculation cast doubt on its financial controls. FINRA found, and the Firm does not deny, that the Firm's net capital computation did not comply with GAAP, did not satisfy Rule 15c3-1, and overstated its net capital. The Firm failed to account for any item other than the amount of cash in the Firm's account, and did not reflect a $700 office rent deposit, monthly rent, or other liabilities. FINRA recalculated the Firm's net capital and determined it to be $5,792—a level that would require the Firm to make an early warning notification under Exchange Act Rule 17a-11. The Firm argues that the net capital computation in Exchange Act Rule 15c3-1 was inapplicable because the Firm was not an operating member firm when it submitted the computation and it complied "to the extent possible." But as noted above, FINRA Rule 1014(a) requires applicants to demonstrate their ability to comply with federal securities rules, which include Rule 15c3-1.[20] The Firm also disputes FINRA's finding that its net capital fell below the early warning requirement, claiming that FINRA's net capital calculation erroneously included a "hypothetical" rent expense and that FINRA's miscalculation resulted from its failure to "read her office lease thoroughly." But, as noted above, it was appropriate for FINRA to consider rent as an operating expense because the Application stated that the Firm expected to run its business from rented office space. The Firm states that it did not include the rent deposit or expenses in its net capital computation to show "that the Firm did not have any liabilities." But this explanation does not justify the Firm's departure from GAAP. As the NAC found, such "attempt[s] to reduce the appearance of the firm's liabilities, whether intentional or merely negligent, reflect[] poorly on the firm's financial controls."

The Firm argues that the Application included "complete and accurate raw information" that excused the errors in net capital calculation and reporting. But this argument is inapposite. The fact that the Firm supplied "raw information" does not excuse its submission of financial reports and calculations that improperly classified assets and liabilities and that failed to comply with GAAP.[21]

Bering Strait claims that its written plans and procedures will ensure its compliance and that FINRA waived any objection to the Firm's financial controls by failing to object to its written plans and procedures. But the adequacy of the Firm's written procedures is beside the point because FINRA did not base its determination on them.

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[20] *See Grand Sec. Co.*, 1992 WL 224081, at *3 n.8 (rejecting applicant firm's argument that the net capital rule applies only to "firms effecting securities transactions" and explaining that "one important purpose of the pre-membership application process is to ensure that a firm would have an adequate level of capital to satisfy the NASD's financial responsibility standards were it to begin operations").

[21] *See North Woodward Fin. Corp.*, 2009 WL 2488066, at **4-5 (rejecting the firm's claim that providing the "underlying source documents" satisfied the requirement to maintain general ledger and trial balances that properly classified transactions under FINRA recordkeeping rules); *Barbera*, 2000 WL 1671434, at *5 (rejecting claim that failure to keep current trial balances was excused because the underlying records were "available to the NASD staff").

The Firm claims that it complied with the requirements "to the extent possible" and asserts that, if the Application is approved, it would comply in the future. Information submitted with a membership application shows whether a firm has financial controls in place to ensure compliance with the requisite financial reporting and calculation requirements. Here, as FINRA found, Ermolova did not know that net capital was required to be calculated pursuant to GAAP and demonstrated a "failure to understand the basis for classifying assets and liabilities." FINRA reasonably concluded that the reporting and calculation errors in the Application resulted from these fundamental gaps in the sole proprietor's knowledge. These shortcomings also cast doubt on the Firm's claims about Ermolova's credentials and experience. We agree with FINRA that the Firm's blanket, unsupported assertions of future compliance were not persuasive in light of the errors in the balance sheet, financial projections, and net capital calculation, as well as the "serious financial management issues" reflected in the Application.

3. *The Firm failed to establish that its supervisory system is adequate to prevent and detect violations of the securities laws and rules.*

FINRA Rule 1014(a)(10) requires the applicant firm to establish that it has a "supervisory system . . . designed to prevent and detect, to the extent practicable, violations of the federal securities laws, the rules and regulations thereunder, and [FINRA] Rules." The applicant firm must establish the adequacy of the supervisory system based on, among other things, the nature of the proposed business; the number, experience (direct and indirect), and qualifications of supervisory personnel; and any other factors that "will have a material impact on the [Firm's] ability to detect and prevent violations."

FINRA concluded that the Firm has not established the adequacy of its supervisory system because it has not shown that Ermolova is prepared to serve as the Firm's FINOP, CCO/AMLCO, and sole supervisor. We agree. Although Ermolova possesses requisite licenses to act as a supervisor, and has two years of investment banking experience, the Firm proposes to operate as a sole proprietorship under Ermolova's supervision "with no checks and balances" and, at the same time, Ermolova plans to support the Firm's operating expenses with part-time work.[22] In assessing this supervisory system, FINRA reasonably considered the fact that Ermolova's experience did not include any supervisory or firm-wide financial reporting or compliance responsibilities. FINRA also considered errors in the Application and Ermolova's hearing testimony demonstrating a "lack of understanding" in the areas that would be subject to her supervision, including her unawareness of the GAAP requirements for calculating net capital. We agree with FINRA that these facts suggest that Ermolova's claims about the adequacy of her preparation to serve as the Firm's FINOP, CCO/AMLCO, and sole supervisor are "unreliable," "apparent[ly] exaggerate[ed]," and "mischaracteriz[ed]."

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[22] FINRA does not prohibit managers from working on a part-time basis, but in evaluating membership applications it evaluates "whether a person functioning on less than a full-time basis can properly discharge the responsibilities of the position." *See* http://www.finra.org/industry/processing-membership-applications (last visited Sept. 11, 2015).

The Firm argues that FINRA failed to adequately consider her two years of non-supervisory experience in the securities industry. To the contrary, FINRA acknowledged this experience but nevertheless concluded that the Firm had not established that Ermolova was sufficiently prepared to serve as the Firm's FINOP, CCO/AMLCO, and sole supervisor. For example, FINRA reasonably rejected the Firm's claims that Ermolova is qualified to serve as FINOP based on her experience as an independent contractor running a home office for Mid-Market Securities and preparing various financial reports (e.g., for client fee schedules, reimbursement reports, and client financial statements). None of the duties described in Ermolova's independent contractor agreement with Mid-Market Securities establish that she is prepared to take responsibility for a broker-dealer's financial reporting. It is undisputed that she never prepared or filed a FOCUS report, which is one of the main responsibilities of a FINOP. The Firm argues that the blank FOCUS Report and other written financial procedures in the Application demonstrate the adequacy of the Firm's financial reporting supervision. But blank forms and written procedures do not ensure that the forms will be completed correctly or that the procedures will be implemented properly. The Firm's claims are particularly unpersuasive because Ermolova was responsible for the errors in the net capital computations and financial reports included in the Application.

Nor does the record establish that Ermolova is prepared to undertake firm-wide compliance responsibilities as CCO or AMLCO. As FINRA observed, the Firm has not produced any evidence to support Ermolova's claims of relevant firm-wide compliance experience, and much of the experience the Firm cites "do[es] not represent functions unique to compliance officers" of member firms and ultimately "evinces a lack of understanding of what actual compliance work entails." The Firm asserts that Ermolova has experience with a laundry list of compliance issues, including suitability, due diligence, and generally watching for compliance-related red flags.[23] But Ermolova's independent contractor agreement with Mid-Market Securities indicates, and the Firm's brief acknowledges, that she was not responsible for resolving compliance issues, but only for reporting them to Mid-Market's compliance officer. The Firm argues that FINRA was precluded from objecting to her acting as CCO because it did not object to the Firm's written compliance procedures or forms. But as noted above, written procedures alone do not establish adequate supervision, particularly without evidence that those procedures will be effectively implemented.[24] FINRA considered Ermolova's lack of relevant experience in light of the Application as a whole and reasonably concluded that the Firm was not prepared to implement compliance systems.

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[23] The Firm also argues that Ermolova's experience in fulfilling regulatory requirements with authorities, such as the New York Department of State, the Internal Revenue Service and the United States Postal Service and the United States Small Business Administration, demonstrates the requisite experience. But Ermolova has offered no evidence demonstrating that such experience prepared her to run an investment banking business as a sole proprietor.

[24] *See, e.g., CapWest Sec. Inc.*, Exchange Act Release No. 71340, 2014 WL 198188, at *8 (Jan. 17, 2014) (finding that "[a]lthough the Firm had adequate supervisory procedures in place, it did not effectively implement them" because "supervisory personnel did not have an adequate understanding of the Firm's obligations").

The Firm's claims about Ermolova's preparation to serve as sole proprietor and investment banking supervisor are similarly unpersuasive. The Firm argues that FINRA does not prohibit sole proprietorships and does not require firm-wide supervisory experience to supervise others, but the Firm did not demonstrate that Ermolova is otherwise prepared to undertake such responsibilities. The Firm claims that Ermolova's experience running her home office as an independent contractor was "almost identical to running [her] own business." The Firm also argues that Ermolova's leadership of firm-wide initiatives and Mid-Market Securities' offer to let her run her own Office of Supervisory Jurisdiction were evidence that she is prepared to fill a supervisory role. But the record does not substantiate these claims. As FINRA observed, the Application included evidence that over several years Ermolova earned total securities industry compensation of approximately $8,500, which casts doubt on the Firm's claims about Ermolova's role and the extent of her responsibilities and suggests that the Firm has either mischaracterized or exaggerated Ermolova's experience. The Firm asserts that Ermolova's compensation was not representative of the extent of her experience and did not reflect her independent work or her supervision of a Mid-Market Securities intern. But Ermolova's ability to work independently or supervise an intern does not establish her ability to supervise registered representatives. The Firm also claims that Ermolova's qualifications are enhanced by the fact that she was granted United States permanent residency based on her "finance industry and international leadership experience." But none of the Firm's arguments undermine FINRA's conclusions that the Firm's claims about Ermolova's experience were exaggerated and that the Firm failed to demonstrate Ermolova's ability to run a broker-dealer as a sole proprietorship or supervise others.

Bering Strait argues that FINRA erroneously relied on *Sierra Nevada Securities, Inc.*,[25] and that the case is distinguishable given Ermolova's investment banking experience. We disagree. In *Sierra Nevada*, we found that the proposed supervisor did not have the highly "specialized training and expertise" in the areas of supervision—even though he was licensed to act as a general securities principal.[26] Bering Strait, like Sierra Nevada, failed to demonstrate that Ermolova has the "hands-on" or other sufficiently related and specialized experience to prepare her to take firm-wide responsibility for financial operations, compliance, or supervision of other registered representatives.[27]

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We find that FINRA's grounds for denying Bering Strait's application exist in fact and that Bering Strait failed to meet its burden of demonstrating that it satisfied FINRA's membership standards.

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[25] Exchange Act Release No. 41330, 1999 WL 239682 (Apr. 26, 1999).

[26] *Id.* at *4.

[27] *Id.* at *3.

C. FINRA's denial of the Application was in accordance with FINRA rules.

FINRA's denial of the Application was in accordance with FINRA's By-laws and membership standards. FINRA is authorized under Article III, Section 2 of its By-laws to set "financial responsibility and operational capability" standards for membership and to make membership decisions after taking into account the "nature, extent, and type of" securities business proposed by the Applicant. FINRA Rule 1014(a) sets the financial responsibility and operational capability framework for FINRA membership decisions. FINRA's denial was based on a reasonable application of the net capital, financial control, and supervision standards.\

Bering Strait claims that FINRA must admit any firm that meets minimum requirements, and that FINRA denied the Application based on criteria not expressly set forth in Rule 1014. It claims that FINRA should have ensured the Firm satisfied the admission standards. But the burden rests on the applicant to meet the membership standards and to show that its membership is in the public interest.[28] As we have previously explained, industry participation is a privilege, not a right, and FINRA has discretion to apply and interpret its membership rules.[29] As described in more detail above, FINRA reasonably interpreted those rules in denying Bering Strait's application for membership.

We find that FINRA satisfied applicable procedural requirements under FINRA Rule 1015(j)(2) by describing the principle issues, summarizing the evidence, and stating the basis for its decision. FINRA afforded the Firm an opportunity to be heard and to submit evidence on each of the bases for the decision. Accordingly, we find that FINRA's decision to deny the Application was in accordance with its Rules.

The Firm claims that the FINRA decision was based on evidence that was raised for the first time at the NAC hearing and disputes this evidence. The Firm argues that this evidence

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[28] *Order Granting Approval of Proposed Rule Change*, Exchange Act Release No. 48969, 2003 WL 23013103, at *3 (Dec. 31, 2003) (stating that "because [FINRA] is a member organization charged with the protection of investors and the public interest, it is fair to require applicants to show why membership should be granted"). To the extent that the Firm argues inadequate notice of the rules, we find that FINRA Rule 1014 affords FINRA appropriate "discretion in interpreting and applying" these standards and that the application itself explained the standards. As noted above, the application of the membership standards in this case was reasonable.

[29] *Cf. Kornman v. SEC*, 592 F.3d 173, 188 (D.C. Cir. 2010) (describing industry participation as "a privilege voluntarily granted" rather than a right) (quoting *Hudson v. United States*, 522 U.S. 93, 104 (1997)); *Timothy P. Pedregon*, Exchange Act Release No. 61791, 2010 WL 1143089, at *6 & n.32 (Mar. 26, 2010) (holding that FINRA was fully justified in requiring a firm to provide specifics before approving an application rather than accepting assurances that the firm would later devise an appropriate plan); *Timothy H. Emerson*, Exchange Act Release No. 60328, 2009 WL 2138439, at *6 (July 17, 2009) (holding that drafting a supervisory plan is the firm's responsibility, not FINRA's).

prejudiced the NAC, but acknowledges that the NAC did not base its decision on that evidence.[30] The Firm also argues that the NAC improperly made findings about an issue that Member Regulation did not previously identify, i.e., the Firm's accounting for cashback credit card rewards. But we find that the Firm had ample notice of the relevance of this issue to FINRA's membership decision because the Firm's own Application described these rewards as a source of revenue and, contrary to the Firm's claim, the Member Regulation denial letter noted concerns about this purported source of revenue.[31] Moreover, we do not find any evidence of improper prejudice, since the NAC's determination was grounded in the facts described in its decision, including facts derived from the Firm's own Application. The Firm also asserts that FINRA failed to consider the Firm's qualifications, and that the outcome was predetermined. To the contrary, FINRA appropriately considered the Firm's assertions but found them unpersuasive in light of the evidence in the record.[32] FINRA's thorough consideration of the Application undermines the Firm's claim that the outcome was predetermined.

The Firm also contends that FINRA did not timely comply with the appeal procedures under FINRA Rule 1015, citing delays in the transmission of the full record, the hearing, and the closing arguments in connection with the NAC appeal. But the Firm has not shown how any such delays rendered the decision unfair.[33] Based on our independent review of the record we find no evidence that these delays affected the analysis or outcome of the NAC decision.

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[30] Member Regulation introduced testimony concerning a specific investment banking deal, a telephone conversation with Ermolova's former supervisor, and an analysis of the Firm's capital transfers. The NAC concluded that addressing this testimony on appeal could raise "notice or fairness issues," and did not rely on the evidence in its decision. *See supra* note 8.

[31] *Cf. Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979) (noting that, in administrative proceedings, "[i]t is sufficient if the respondent 'understood the issue' and 'was afforded full opportunity' to justify its conduct during the course of the litigation"). Moreover, even if the NAC had not considered the cashback accounting, this was just one of several red flags identified by the NAC supporting its conclusions that the Firm had not demonstrated the adequacy of its financial controls, net capital, or supervision. Any one of these red flags would have supported the denial of membership. *See Grand Sec. Co.*, 1992 WL 224081, at *3 (explaining that the failure to "comply with any one of these [membership] requirements would be sufficient reason for a denial of membership").

[32] *Cf. Asensio & Co., Inc.*, 2012 WL 6642666, at *14 (noting that similar arguments "confuse the [Firm's] inability to meet its burden under Rule 1014 with its assertion of an inherently unfair . . . process for reviewing" membership applications). The Firm also contends that Member Regulation rushed its interviews, did not fully consider the arguments or Application, and was biased. We do not find support for these claims. In any case, it is the decision of the NAC, not Member Regulation, that is the final FINRA action subject to review in this case.

[33] *See Sierra Nevada*, 1999 WL 239682, at *5 (finding that a procedural error did not deny the firm a fair hearing and that "the only remedy for delay provided for in Rule 1014 is an order requiring that a decision be issued immediately").

D. FINRA rules are, and were applied in a manner, consistent with the Exchange Act.

FINRA acted consistently with the Exchange Act when it denied the membership application. FINRA reasonably exercised its authority under Exchange Act Section 15A(g)(3)(A) to "examine and verify the qualifications of an applicant" based on FINRA standards of "financial responsibility or operational capacity" and "training, experience, and competence."[34]

The application process is designed to "fully evaluate relevant aspects of applicants and to identify potential weaknesses in their internal systems" to ensure that member firms are "capable of conducting their business in compliance with applicable regulation.[35] Each membership standard plays a critical role in protecting the public interest and investors. Net capital is "the principal regulatory tool by which the Commission and [FINRA] monitor the financial health of brokerage firms" and the net capital rule "protect[s] investors from the possible financial collapse of a firm."[36] Effective supervision and controls are critical "investor protection tools" to help "identify and prevent abusive practices."[37] Given the purpose of these requirements, and FINRA's evaluation of the Application and arguments in light of the requirements, we find that FINRA's rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.

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[34] 15 U.S.C. § 78o-3(g)(3)(A); *cf. generally Frank Kufrovich*, Exchange Act Release No. 45437, 2002 WL 215446, at *4 (Feb. 13, 2002) (describing the steps an SRO must take when denying an application under the Exchange Act); *Emerson*, 2009 WL 2138439, at *4 (quoting *Gershon Tannenbaum*, Exchange Act Release No. 31080, 1992 WL 213844, at *2 (Aug. 24, 1992)).

[35] *Duties of Brokers, Dealers, and Investment Advisers*, Exchange Act Release No. 69013, 2013 WL 771910, at *28 (Mar. 1, 2013).

[36] *Joseph Ricupero*, Exchange Act Release No. 62891, 2010 WL 3523186, at *5 (Sept. 10, 2010) (internal quotations omitted), *aff'd* 436 F. App'x 31 (2d Cir. 2011).

[37] *Duties of Brokers, Dealers, and Investment Advisers*, 2013 WL 771910, at *27; *see also Revcon*, 1997 WL 685314, at *7 (finding that OCC's denial of membership "was aimed reasonably at protecting the OCC and the public from the possible risks of admitting a member that cannot demonstrate compliance with the OCC's membership standards").

III. Conclusion

For the foregoing reasons, we have determined to dismiss Bering Strait's appeal. An appropriate order will issue.[38]

By the Commission (Chair WHITE and Commissioners AGUILAR, STEIN, and PIWOWAR).

Brent J. Fields
Secretary

[38] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76307 / October 29, 2015

Admin. Proc. File No. 3-16262

In the Matter of the Application of

BERING STRAIT SECURITIES, INC.

For Review of Action Taken by

FINRA

ORDER DISMISSING REVIEW PROCEEDINGS

On the basis of the Commission's opinion issued this day, it is

ORDERED that the application for review filed by Bering Strait Securities, Inc. is hereby dismissed.

By the Commission.

Brent J. Fields
Secretary