

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-91070; File No. SR-FINRA-2020-037)

February 5, 2021

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Amend the By-Laws of FINRA Regulation, Inc. to Align the Grounds for Member Removal from the NAC with an Existing Provision in the FINRA By-Laws

I. Introduction

On October 22, 2020, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act” or “Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend a provision in the By-Laws of FINRA Regulation, Inc. (“FINRA Regulation”), FINRA’s regulatory subsidiary. The proposed rule change would further align the grounds in the FINRA Regulation By-Laws for removal of a member from the National Adjudicatory Council (“NAC”) with an existing provision in the FINRA By-Laws for removal of a governor from the FINRA Board of Governors (“FINRA Board”).<sup>3</sup>

The proposed rule change was published for comment in the Federal Register on November 9, 2020.<sup>4</sup> The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

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

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

<sup>3</sup> See infra Section II.

<sup>4</sup> See Exchange Act Release No. 90324 (November 3, 2020), 85 FR 71387 (November 9, 2020) (File No. SR-FINRA-2020-037) (the “Notice”).

## II. Description of the Proposal

As described in the Notice, FINRA Regulation is the regulatory subsidiary of FINRA and operates according to the Plan of Allocation and Delegation of Functions by FINRA to Subsidiaries (the “Plan”).<sup>5</sup> The FINRA Regulation By-Laws authorize the NAC to function on behalf of the FINRA Board in several capacities.<sup>6</sup> For example, FINRA explains that the NAC presides over disciplinary matters that have been appealed to or called for review by the NAC and also acts on applications in statutory disqualification and membership proceedings.<sup>7</sup> In most matters that the NAC considers, FINRA states that the NAC prepares proposed written decisions that become final FINRA action if the FINRA Board does not call for review of those decisions.<sup>8</sup>

FINRA also states that it periodically reviews its and FINRA Regulation’s By-Laws to ensure adherence to effective governance practices.<sup>9</sup> Based on that review, FINRA explains that currently, Article V, Section 5.8 of the FINRA Regulation By-Laws provides that, “[a]ny or all of the members of the [NAC] may be removed from office at any time for refusal, failure, neglect, or inability to discharge the duties of such office by majority vote of the FINRA Board.”<sup>10</sup> By comparison, however, the FINRA By-Laws provide that a governor may be

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<sup>5</sup> See id. at 71388, n.4 (citing the Plan, Sec. II., FINRA Regulation, Inc., <https://www.finra.org/rules-guidance/rulebooks/corporate-organization/ii-finra-regulation-inc>).

<sup>6</sup> See id. (citing Article V, Sec. 5.1 of the FINRA Regulation By-Laws).

<sup>7</sup> See id. FINRA states that the NAC also exercises exemption authority and acts in other proceedings as set forth in the FINRA Rule 9000 Series (Code of Procedure). The FINRA Board may also delegate other powers and duties to the NAC as the FINRA Board deems appropriate and in a manner not inconsistent with the Plan. See id.

<sup>8</sup> See id.

<sup>9</sup> See id.

<sup>10</sup> See id. As FINRA explains, the FINRA Regulation By-Laws were amended in 2008 to, among other things, designate the FINRA Board as the body authorized to oversee the

removed for those grounds as well as “for any cause affecting the best interests of [FINRA] the sufficiency of which the Board shall be the sole judge.”<sup>11</sup> As a result, FINRA proposes to amend the FINRA Regulation By-Laws to add this ground for removal of a NAC member to further align the bases for removal of a NAC member with the bases for removal of a FINRA Board governor.<sup>12</sup> Specifically, the proposed rule change would amend the FINRA Regulation By-Laws to permit a NAC member to be removed by a majority vote of the FINRA Board “for any cause affecting the best interests of the [NAC] the sufficiency of which the FINRA Board shall be the sole judge.”<sup>13</sup>

FINRA further explains that the removal of a NAC member would continue to require a majority vote of the FINRA Board, while a vote to remove a FINRA Board governor requires a two-thirds vote.<sup>14</sup> In discussing this difference between voting thresholds for removal, FINRA states that the higher voting standard for the removal of a governor reflects the historical standard that existed at the National Association of Securities Dealers (“NASD”) prior to the

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NAC and empowered to remove NAC members for the grounds mentioned above. See id. (citing Exchange Act Release No. 58909 (November 6, 2008), 73 FR 68467 (November 18, 2008) (Order Approving File No. SR-FINRA-2008-046) (the “FINRA Regulation By-Laws Approval Order”).

<sup>11</sup> See id. Compare Article VII, Section 1(b) of the FINRA By-Laws, with Article V, Sec. 5.8 of the FINRA Regulation By-Laws.

<sup>12</sup> See Notice, 85 FR at 71388.

<sup>13</sup> See id.

<sup>14</sup> See id. As FINRA notes, both FINRA and FINRA Regulation are corporations organized under Delaware law. The Delaware General Corporation Law provides that, in general, directors may be removed by a majority vote of the shares then entitled to vote at an election of directors. See Del. Code Ann. Tit. 8, § 141(k). FINRA states that it has adopted a removal threshold for NAC members that is consistent with the Delaware General Corporation Law, although the NAC is not subject to this standard. See Notice, 85 FR at 71388, n.9.

formation of FINRA, and that it provides an additional safeguard at the FINRA Board level “to ensure a diverse, majority non-industry composition, and fair representation of the industry in governance matters.”<sup>15</sup>

FINRA also states that, given the NAC’s adjudicatory role, the best interests of the NAC are more targeted than the best interests of FINRA.<sup>16</sup> More specifically, FINRA explains that the best interests of the NAC are reflected in conduct and attributes that ensure that the NAC remains an unbiased and competent adjudicatory body that is free of conflicts of interest, that its members conduct themselves with integrity, and that its decisions are rendered fairly and consistently with the law and rules that govern FINRA members and their associated persons.<sup>17</sup> FINRA also states that the FINRA Board’s decision to remove a NAC member is a facts and circumstances determination.<sup>18</sup> In considering whether to remove a NAC member for cause affecting the best interests of the NAC, FINRA explains that its Board may consider, among other things, the NAC member’s adherence to general standards concerning actual and apparent adjudicator conflicts of interest and bias,<sup>19</sup> and to the NAC’s Conflict of Interest and Bias Policy, which sets forth broad-based principles of behavior that are expected from NAC members.<sup>20</sup>

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<sup>15</sup> Notice, 85 FR at 71388. FINRA also notes that the provision of the FINRA Regulation By-Laws addressing the composition of the NAC also provides for a diverse, majority non-industry composition, and for the fair representation of the industry. See id. at n.10 (citing Article V, Section 5.2(a) of the FINRA Regulation By-Laws and Exchange Act Release No. 78094 (June 17, 2016), 81 FR 40932, 40934-35 (June 23, 2016)).

<sup>16</sup> See id.

<sup>17</sup> See id.

<sup>18</sup> See id. at 71388-89.

<sup>19</sup> See id. at 71388, n.11 (citing Article IV, Section 4.14(a) of the FINRA Regulation By-Laws).

<sup>20</sup> See id. at n.12. FINRA notes that the principles outlined in the NAC’s Conflict of Interest and Bias Policy are independence, impartiality, integrity, accountability and

FINRA recognizes that there may, depending on the facts and circumstances, be overlap in part between the new and existing grounds to remove a NAC member. However, FINRA states that, depending on the facts and circumstances, the proposed rule change may also provide an additional basis for removal for a cause affecting the best interests of the NAC that would not fall within the scope of the FINRA's Board's current removal authority.<sup>21</sup>

### III. Discussion and Commission Findings

After careful review of the proposed rule change, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.<sup>22</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(4) of the Exchange Act,<sup>23</sup> which requires, among other things, that the rules of a national securities association, like FINRA, assure the fair representation of its members in the administration of its affairs. Additionally, the Commission finds that the proposed rule change is also consistent with Section 15A(b)(6) of the Exchange Act,<sup>24</sup> which requires, among other things, that FINRA rules 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.

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transparency; and place upon NAC adjudicators the responsibility for recognizing and reporting actual and apparent conflicts of interest and bias. See id.

<sup>21</sup> See id. at 71389.

<sup>22</sup> In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>23</sup> 15 U.S.C. 78o-3(b)(4).

<sup>24</sup> 15 U.S.C. 78o-3(b)(6).

As a threshold matter, the Commission observes that the provision that is being added to the FINRA Regulation By-Laws by this proposed rule change mirrors a parallel provision found in the FINRA By-Laws.<sup>25</sup> Moreover, the Commission has previously reviewed and approved a proposal that conformed the then-NASD Regulation By-Laws to the FINRA By-Laws, and has also previously reviewed and approved the NAC committee and its governance structure (which remains the same under this proposal), finding both proposals to be consistent with Section 15A(b)(4) of the Exchange Act.<sup>26</sup> We discuss below some of the pertinent aspects of the Commission’s prior findings as they apply, at least in part, to the current proposed rule change.

As the Commission explained in approving the FINRA By-Laws, Section 15A(b)(4) requires that the rules of a national securities association, like FINRA, assure the fair representation of its members in, among other things, the administration of its affairs.<sup>27</sup> In approving the FINRA By-Laws, the Commission found, in part, that FINRA’s members’ participation on various committees provided for the fair representation of members in the administration of the affairs of a self-regulatory organization such as FINRA, particularly with respect to participation on committees relating to, among other things, the disciplinary process.<sup>28</sup>

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<sup>25</sup> See Notice, 85 FR at 71388 (comparing Article VII, Section 1(b) of the FINRA By-Laws with Article V, Sec. 5.8 of the FINRA Regulation By-Laws).

<sup>26</sup> See *id.* at n.17 (citing Exchange Act Release No. 56145 (July 26, 2007), 72 FR 42169 (August 1, 2007) (the “NASD By-Laws Approval Order”), as amended by Exchange Act Release No. 56145A (May 30, 2008), 73 FR 32377 (June 6, 2008) (Order Approving File No. SR-NASD-2007-023)). These orders approved FINRA’s By-Laws when the NASD merged with the member regulation, enforcement and arbitration operations of the New York Stock Exchange (“NYSE”) to form FINRA. See also *infra* notes 31-32.

<sup>27</sup> See NASD By-Laws Approval Order, 72 FR at 42182 (explaining that this requirement helps to assure that members have a stake in the governance of the national securities association, which is charged with self-regulatory responsibilities under the Exchange Act).

<sup>28</sup> See *id.* at 42185.

More specifically, the Commission observed that FINRA has extensive member involvement in the administration of its affairs through representation on various subject matter committees, including the NAC.<sup>29</sup> In connection with this proposal, FINRA states that, similar to the FINRA By-Laws addressing the composition of its Board, the FINRA Regulation By-Laws addressing the composition of the NAC provide for a diverse, majority non-industry composition, and for the fair representation of industry.<sup>30</sup> The Commission agrees with FINRA's statements and, moreover, observes that the Commission found previously that the NAC's governance structure, including the NAC's composition as well as the nomination and election processes for NAC seats, align with those of the FINRA Board and were consistent with Section 15A(b)(4) of the Act.<sup>31</sup>

Furthermore, in approving certain amendments to the then-NASD Regulation By-Laws, the Commission found that because those amendments conformed certain NASD Regulation By-Laws provisions to the relevant provisions in the FINRA By-Laws and reflected the governance structure set forth in the FINRA By-Laws those amendments were consistent with the Exchange Act.<sup>32</sup> Similarly, this proposal will also further conform the FINRA Regulation By-Laws with the FINRA By-Laws and will also continue to reflect the previously approved governance structure of the NAC. As a result, the Commission believes that this proposal will continue to help assure the fair representation of FINRA members in the administration of FINRA's affairs and, therefore, is consistent with Section 15A(b)(4) of the Act.

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<sup>29</sup> See id. See also supra note 7 and accompanying text.

<sup>30</sup> See supra note 15 and accompanying text.

<sup>31</sup> See FINRA Regulation By-Laws Approval Order, 73 FR at 68469-70.

<sup>32</sup> See NASD By-Laws Approval Order, 72 FR at 42188.

The Commission further observes that the NAC acts on behalf of the FINRA Board in several important capacities, including presiding over disciplinary matters that have been appealed to or called for review by the NAC and acting on applications in statutory disqualification and membership proceeding.<sup>33</sup> Given the NAC's ability to perform these actions and prepare written decisions on behalf of the FINRA Board, and that these decisions become FINRA's final action in the vast majority of cases,<sup>34</sup> the Commission finds that applying the same grounds for the removal of a NAC member as those that apply for the removal of a governor is consistent with the Act. The proposal will strengthen the FINRA Board's oversight of the NAC and further support the principles outlined in the NAC's Conflict of Interest and Bias Policy, which include independence, impartiality, integrity, and accountability.<sup>35</sup> In doing so, the proposal will help protect investors and further the public interest by expanding the scope of the FINRA Board's authority to remove NAC members that, in the Board's view, may be biased or have actual or apparent conflicts of interest or otherwise impede the NAC's adjudicatory responsibilities.<sup>36</sup>

In sum, the Commission finds that the proposal will continue to help assure the fair representation of FINRA members in the administration of FINRA's affairs. The Commission also finds that this proposal will help protect investors and further the public interest by supporting fair and impartial adjudicatory processes for, among other things, FINRA's disciplinary matters as well as statutory disqualification and membership proceedings.

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<sup>33</sup> See supra note 7 and accompanying text.

<sup>34</sup> See Notice, 85 FR at 71389.

<sup>35</sup> See id. at 71388, n.12. See also supra note 20 and accompanying text.

<sup>36</sup> See id. at 71388 (citing Article IV, Section 4.14(a) of the FINRA Regulation By-Laws).

IV. Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Exchange Act<sup>37</sup> that the proposal (SR-FINRA-2020-037) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>38</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>37</sup> 15 U.S.C. 78s(b)(2).

<sup>38</sup> 17 CFR 200.30-3(a)(12).