



Financial Industry Regulatory Authority

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June 13, 2016

Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: File No. SR-FNRA-2016-014 – Response to Comments

Dear Mr. Fields:

This letter responds to comments submitted to the Securities and Exchange Commission (“Commission”) regarding the above-referenced filing, a proposed rule change to amend the By-Laws of FINRA’s regulatory subsidiary, FINRA Regulation, Inc. (“FINRA Regulation”), to expand the size of the National Adjudicatory Council (“NAC”) to 15 members, with the number of non-industry members exceeding the number of industry members; lengthen the terms of office of future NAC members to four years; and update the process used for sending and counting ballots in the event of a contested nomination and election to fill certain NAC industry member seats. The proposed rule change was published for comment in the Federal Register on May 13, 2016.<sup>1</sup>

The Commission received four comment letters in response to the publication of the proposed rule change in the Federal Register.<sup>2</sup> One commenter unequivocally favored the proposed rule change.<sup>3</sup> One commenter commended FINRA for suggesting changes to the NAC but expressed concerns about altering the NAC’s

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<sup>1</sup> Securities Exchange Act Release No. 77786 (May 9, 2016), 81 FR 29929 (May 13, 2016).

<sup>2</sup> See Letter from Steven B. Caruso, Esq., Maddox Hargett Caruso, P.C., May 9, 2016 (“Caruso”); Letter from David T. Bellaire, Esq., Executive Vice President and General Counsel, Financial Services Institute, May 19, 2016 (“FSI”); Letter from Christopher E. Berman, Barry University, Dwayne O. Andreas School of Law, June 2, 2016 (“Berman”); Letter from Hugh D. Berkson, President, Public Investors Arbitration Bar Association, June 2, 2016 (“PIABA”).

<sup>3</sup> Caruso.

composition and lengthening member terms.<sup>4</sup> Finally, two commenters generally supported the proposal but urged FINRA to consider an increase in the minimum number of public members that must serve on the NAC.<sup>5</sup>

The following is FINRA's response, by topic, to the material concerns expressed in the commenters' letters.

First, FSI expressed concern that increasing the number of non-industry members may diminish the NAC's expertise and stated that the NAC's current composition, with the number of industry members equaling the number of non-industry members, better attains a more balanced perspective. FINRA disagrees that adding one non-industry NAC member will diminish the expertise of the NAC or the quality of its deliberations and decisions. The proposed, limited modification enhances overall the independence of the NAC, enriches the diversity of views that inform the NAC's opinions, and acknowledges the valuable insight and expertise that non-industry NAC members add to the adjudicatory process.<sup>6</sup> The proposed rule change recognizes and embraces also the indispensable input and expertise of the NAC's industry members and thus maintains FINRA's custom of substantial industry participation in the NAC's adjudication of disciplinary and other matters. The proposed rule change accordingly would not dilute the critically important involvement of FINRA members and their associated persons in NAC deliberations by maintaining the current total number of NAC industry members (seven).

Second, although FSI recognizes the benefits of lengthening NAC member terms to four years, it expressed concern that this could create unintentional stagnation and may result in an insufficiency of varied viewpoints in NAC deliberations over time.<sup>7</sup> FINRA believes that the benefits that FSI has documented in support of

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<sup>4</sup> FSI.

<sup>5</sup> Berman, PIABA.

<sup>6</sup> FINRA is committed to appointing non-industry NAC members that are both highly qualified and provide unique perspectives in NAC deliberations. Non-industry NAC members have included, among others, distinguished professors of law, finance, and business, current and former public pension and retirement system advisers, and leaders of independent, non-profit organizations that provide educational and outreach programs to issuers and investors. Such non-industry members provide the NAC with expertise in a variety of subjects and issues important to the matters the NAC considers, including the federal securities laws, just and equitable principles of trade, best professional practices, and corporate governance and compliance.

<sup>7</sup> FSI suggested that FINRA reevaluate the effectiveness of the proposed rule change after three tranches of NAC members serve four-year terms. The NAC's

lengthening NAC member terms outweigh significantly the risks identified by FSI. The proposed rule change would maintain current NAC member term limits that allow for a regular infusion of fresh ideas and knowledge and generally serve the goal of invigorating NAC deliberations.<sup>8</sup> Moreover, NAC members are divided currently into three classes, with members serving three-year terms of office that commence and expire on a staggered, annual basis.<sup>9</sup> The proposed rule change would result in a NAC that is divided into four, staggered classes. Accordingly, under the proposed rule change, the composition of the NAC will continue to change each year. NAC members, both industry and non-industry, feel that the substantive work and formal processes of the NAC require a longer term to be fully productive.

Finally, Berman and PIABA urged FINRA to consider increasing the number of non-industry NAC members that must also be public members.<sup>10</sup> Both expressed concern that instances could arise where certain non-industry members of the NAC remain susceptible to pressure because of their connections to the securities industry. FINRA believes these concerns are misplaced.<sup>11</sup> The proposed rule change would

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decisions are generally subject to discretionary review by the FINRA Board of Governors (“Board”). See, e.g., NASD Rule 1016; FINRA Rule 9351; FINRA Rule 9525. The Board is well placed to conduct an ongoing evaluation of the NAC’s effectiveness and the quality of its decision making. FINRA thus believes that amending the proposed rule change to establish a date for reevaluating the effectiveness of longer NAC member terms is unnecessary.

<sup>8</sup> A NAC member, absent a limited exception, may not serve consecutive terms. See FINRA Regulation By-Laws, Article V, Section 5.6 (Term of Office), paragraph (c). The proposed rule change makes only a conforming amendment to this provision.

<sup>9</sup> See FINRA Regulation By-Laws, Article V, Section 5.6 (Term of Office), paragraphs (a) and (b).

<sup>10</sup> The current FINRA Regulation By-Laws and the proposed rule change require that the NAC include at least three “Non-Industry Members” that are also “Public Members.” See FINRA Regulation By-Laws, Article V, Section 5.2 (Number of Members and Qualifications), paragraph (a).

<sup>11</sup> PIABA, for example, questioned whether the officers and employees of some issuers would qualify as non-industry NAC members because the issuers with which they are associated or the employees may also be required to register as broker-dealers. As the Commission guidance cited by PIABA makes clear, however, an issuer generally is not a broker-dealer and the employee of an issuer who participates in the sale of the issuer’s securities ordinarily would not have to register as a broker-dealer if certain conditions are met. Moreover, an officer or employee of an issuer that is also a broker-dealer clearly would not qualify to serve as a non-industry member of

amend the FINRA Regulation By-Laws to expand the size of the NAC to 15 members and apply the requirement that the NAC have more non-industry members, including three public members, than industry members, thus following closely the requirement that exists in the FINRA By-Laws that the number of public governors that serve on the Board exceed the number of industry governors. Although the terms “Non-Industry Member” of the NAC and “Public Governor” of the Board are not by their definitions exact analogs, they are comparable.<sup>12</sup> FINRA believes that increasing the number of non-industry NAC members that must also be public members would unnecessarily restrict the flexibility inherent in FINRA’s current ability to appoint to the NAC a diversity of non-industry members and public members that serve best, based on the pool of potential candidates, to strengthen the quality of the NAC as an adjudicatory body and its deliberations and decisions.<sup>13</sup>

FINRA believes that the foregoing responds to the issues raised by the commenters. If you have any questions, please contact me at [REDACTED].

Very truly yours,



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Associate General Counsel

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the NAC. The term “Non-Industry Member” explicitly excludes any individual that would otherwise fall within the definition of “Industry Member.” See FINRA Regulation By-Laws, Article I, paragraph (ee). The term “Industry Member,” in turn, explicitly includes any individual that has served in the prior year as an officer, director, employee or controlling person of a broker-dealer. See FINRA Regulation By-Laws, Article I, paragraph (x).

<sup>12</sup> Compare FINRA Regulation By-Laws, Article I, paragraph (ee), with FINRA By-Laws, Article I, paragraph (tt).

<sup>13</sup> Although the FINRA Regulation By-Laws and the proposed rule change require that the NAC include, at a minimum, three public members, they do not limit the ability of the Board to appoint to the NAC greater than three public members.