

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-59696; File No. SR-FINRA-2009-020)

April 2, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to the FINRA Regulation Board Composition and Conforming Changes to the FINRA Regulation By-Laws

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 27, 2009, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend the By-Laws of FINRA’s regulatory subsidiary (“FINRA Regulation”) to modify the FINRA Regulation Board (“FINRA Regulation Board”) composition, to adopt changes to conform the FINRA Regulation By-Laws to the FINRA By-Laws, and to reflect the corporate name change and similar matters.

The text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

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

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

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background on FINRA and Its Regulatory Subsidiary

On July 30, 2007, NASD and the New York Stock Exchange consolidated their member firm regulation operations into a combined organization, FINRA. As part of the consolidation, the SEC approved amendments to the NASD By-Laws to implement governance and related changes.<sup>3</sup> The approved changes included a FINRA Board governance structure that balanced public and industry representation and designated seven governor seats to represent member firms of various sizes based on the criteria of firm size.

FINRA Regulation (formerly known as NASD Regulation) is a subsidiary of FINRA that operates according to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries, as amended, which NASD adopted first in 1996 when it formed

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<sup>3</sup> See Securities Exchange Act Release No. 56145 (July 26, 2007), 72 FR 42169 (August 1, 2007), as amended by Securities Exchange Act Release No. 56145A (May 30, 2008), 73 FR 32377 (June 6, 2008) (File No. SR-NASD-2007-023).

NASD Regulation. FINRA Regulation's By-Laws were not amended at the time of the consolidation, other than in a few sections where those By-Laws conflicted with the new FINRA By-Laws. On November 6, 2008, the Commission approved a proposed rule change to amend Articles I, II, III, V, VI, VII, IX, X and XIII, Section 4.16 of Article IV, and all of Article VIII except Section 8.7 and all of Article XII except Section 12.3, to realign the representation of industry members on the National Adjudicatory Council to follow more closely the categories of industry representation on the FINRA Board. See SR-FINRA 2008-046, Securities Exchange Act Release No. 58909 (November 6, 2008), 73 FR 68467 (November 18, 2008).

#### Changes to the FINRA Regulation Board Composition to Parallel the FINRA Board

The proposed rule change would make limited modifications to Article IV of the FINRA Regulation By-Laws to parallel more closely the governance structure of the FINRA Board. To reflect FINRA's current governance structure, the proposed rule change establishes that FINRA Regulation Board members are drawn exclusively from the FINRA Board.<sup>4</sup> In accordance with this change, the National Adjudicatory Council (NAC) Chair will no longer be a member of the FINRA Regulation Board.<sup>5</sup> The rule change also eliminates specific references to representatives of an issuer of investment company shares and an insurance company (or affiliated members) from the required composition of the Board. Because the FINRA Board includes a Floor Member Governor, an Independent Dealer/Insurance Affiliate Governor and an

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<sup>4</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.3 (a) (Qualifications). The current provision provides, in part, that "[t]he Board shall include the President and the National Adjudicatory Council Chair, representatives of an issuer of investment company shares or an affiliate of such an issuer, and an insurance company or an affiliated NASD member."

<sup>5</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.3(a) (Qualifications). The NAC Chair's automatic service on the FINRA Board of Governors was eliminated in

Investment Company Affiliate Governor, any of these Governors may serve on the subsidiary's Board.

The proposed rule change would apply to the FINRA Regulation Board the requirement, which exists in the FINRA By-Laws, that the FINRA Regulation Board have more Public Directors than Industry Directors.<sup>6</sup> In furtherance of this change, references throughout Article IV to balancing Industry and Non-Industry Board members have been replaced with references to balancing Industry and Public Board members. The proposal likewise would remove the requirement that the Executive Committee include at least one Public Director and institute the requirement that Public Directors shall exceed Industry Directors on FINRA Regulation's Executive Committee of the Board.<sup>7</sup>

The proposed rule change would continue FINRA's custom of substantial industry participation on the board of its regulatory subsidiary. Currently, selection of the FINRA Board includes a petition process that allows for additional candidates for seven Industry Governor seats to be elected in contested elections. To ensure that the fair representation of industry members on the FINRA Board is similarly reflected on the FINRA Regulation Board, the proposal would establish that the FINRA Regulation Board include 20%, and not less than two,

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2007 as one of the changes to the FINRA By-Laws made during the NASD and NYSE consolidation.

<sup>6</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.3 (a) (Qualifications). The current provision provides, in part, that “[t]he number of Non-Industry Directors shall equal or exceed the number of Industry Directors.”

<sup>7</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.13(f) (Committees). The current provision provides, in part, that “[t]he Executive Committee shall consist of three or four Directors, including at least one Public Director. The President of NASD Regulation shall be a member of the Executive Committee. The number of Non-Industry committee members shall equal or exceed the number of Industry committee members.”

Small, Mid-Size, or Large Firm Governors.<sup>8</sup> These provisions would establish a minimum floor of 20% of the FINRA Regulation Board Directors coming from FINRA Governor seats with potential contested elections and would ensure that a minimum of two such Governors would serve on the FINRA Regulation Board.<sup>9</sup>

The proposed rule change would clarify the conditions under which the FINRA Regulation Board can meet. The current FINRA Regulation By-Laws instruct that a Director can waive notice of a Board meeting by being present at the meeting, so long as the Director did not attend the meeting solely to object to the meeting taking place.<sup>10</sup> The proposed addition to Section 4.12(c) clarifies that a Board meeting is a legal meeting if all Directors are present and no Director is present solely for the purpose of objecting to the meeting taking place.

#### Post-Consolidation Changes to FINRA Board Responsibilities

The proposed rule change would implement minor alterations regarding removing FINRA Regulation Board members, filling a vacant board seat, and selection of the Chair of FINRA Regulation's Board. FINRA Regulation is a stock corporation organized in the state of Delaware. First, the proposal would transfer the authority to remove Directors from a majority vote of the FINRA Board to the stockholder of FINRA Regulation<sup>11</sup> to accommodate Delaware

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<sup>8</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.3 (Qualifications). The current provision provides, in part, that “[i]f the Board consists of 5–7 Directors, it shall include at least one Public Director. If the Board consists of eight to nine Directors, at least two Directors shall be Public Directors. If the Board consists of ten to twelve Directors, at least three Directors shall be Public Directors, and if the Board consists of thirteen to fifteen Directors, at least four shall be Public Directors.”

<sup>9</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.3(a) (Qualifications).

<sup>10</sup> See current FINRA Regulation By-Laws, Article IV, Section 4.12(b) (Notice of Meeting; Waiver of Notice) and Article XII, Section 12.3(b) (Waiver of Notice).

<sup>11</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.6 (Removal). The sole stockholder of the capital stock of FINRA Regulation is FINRA, Inc. See Article XI, Section 11.1 (Sole Stockholder).

law, which requires that a stock corporation vest the power to remove directors with the stockholder.<sup>12</sup> Second, Directors of FINRA Regulation currently are elected annually at the meeting of FINRA Regulation’s stockholder or at a special meeting dedicated to FINRA Regulation Board elections. When the annual election of Directors is not held on the designated date, the By-Laws charge the Directors to “cause such election” to be held.<sup>13</sup> The proposed rule change would confirm that the same process should be used by the FINRA Regulation Board when filling vacancies among its ranks. The proposal would adopt language that the FINRA Board shall “cause the election” of a qualified Director to fill the vacant position.<sup>14</sup> Third, the proposal would transfer the task of selecting the Chair of the FINRA Regulation Board from the Board members to FINRA Regulation’s stockholder.<sup>15</sup> The proposal also would:

- Eliminate the requirement that the Board select a Vice Chair as unnecessary;<sup>16</sup>

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<sup>12</sup> See Delaware General Corporation Law, § 141(k). As a practical matter, the FINRA Board generally would be asked to pass a resolution authorizing an officer of FINRA to execute a sole stockholder consent on behalf of FINRA (who is the sole stockholder of FINRA Regulation) before such a consent is executed. As such, the FINRA Board would have a voice in the matter, but as a matter of Delaware law, the consent authorizing the removal must be executed by a duly authorized officer of FINRA in FINRA’s capacity as sole stockholder.

<sup>13</sup> See current FINRA Regulation By-Laws, Article IV, Section 4.4 (Election).

<sup>14</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.8 (Filling of Vacancies). Pursuant to the General Corporation Law, FINRA, as the sole stockholder of FINRA Regulation, has the authority to execute a stockholder consent electing an individual to fill the vacancy pursuant to directions of the FINRA Board. Alternatively, the FINRA Board may pass a resolution making it known who they would like appointed to fill the vacancy. Under this scenario, it is likely that the remaining members of the FINRA Regulation Board will follow the advice of its controlling stockholder and elect the recommended individual. See Delaware General Corporation Law, § 223.

<sup>15</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.3(b) (Qualifications). See also Delaware General Corporation Law § 142, which allows the sole stockholder to make this selection if expressly provided for in the By-Laws.

<sup>16</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.3(b) (Qualifications).

- Indicate that the stockholder would designate the Chair at the same time that the Directors are elected;<sup>17</sup>
- Eliminate as unnecessary the reference to the first meeting of NASD Regulation at which Directors initially were elected;<sup>18</sup>
- Clarify that when a Director is disqualified from Board service and the Director's remaining term is not more than six months, the Board may continue to operate and will not violate any compositional requirements if it does not replace the disqualified Director;<sup>19</sup>
- Remove the requirement that written notice of resignation by Directors be submitted to the President;<sup>20</sup> and
- Eliminate as unnecessary a cross-reference in the quorum provision and state that, when there is a quorum, a majority vote of the Directors present at a meeting constitutes action of the Board.<sup>21</sup>

#### Changes To Reflect Practices Regarding the Capital Stock of FINRA Regulation

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<sup>17</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.3(b) (Qualifications). The current provision provides, in part, that the Board shall designate a Chair "as soon as practicable, following the annual election of Directors."

<sup>18</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.4 (Election).

<sup>19</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.7 (Disqualification).

<sup>20</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.5. The current provision provides, in part, that "[a]ny Director may resign at any time either upon written notice of resignation to the Chair of the Board, the President, or the Secretary." Under the proposed provision, notice of resignation must be submitted to the Chair of the Board or the Secretary.

<sup>21</sup> See proposed FINRA Regulation By-Laws, Article IV, Section 4.9(b) (Quorum and Voting).

The proposed rule change would amend several provisions regarding FINRA Regulation's capital stock. FINRA's approach to the corporate law issue of signing certificates representing shares of FINRA Regulation capital stock is to have these shares signed by FINRA Regulation officers. Because FINRA Regulation does not have an officer as Chair of the Board, the possibility of the Chair signing stock certificates is being deleted.<sup>22</sup> The proposal would eliminate limitations on when signatures on certificates representing shares of FINRA Regulation's capital stock may be facsimiles and would allow any signature to be a facsimile.<sup>23</sup> Given that currently certificates representing capital stock may be sealed with a facsimile of FINRA Regulation's corporate seal, this change would apply the same flexible approach to signatures on the certificates.

Currently, one section of the By-Laws requires that the FINRA Regulation Secretary, or another officer, employee, or agent, keep a record of FINRA Regulation's capital stock ownership and "the number of shares represented by each such certificate."<sup>24</sup> Tracking this language and applying it elsewhere, the proposal would change several phrases that discuss capital stock to "certificates representing shares of capital stock" or similar constructions instead of "certificates for shares of capital stock." This change would make the By-Laws more consistent with the language of the applicable section of the General Corporation Law of the

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<sup>22</sup> See proposed FINRA Regulation By-Laws, Article XI, Section 11.3(a) (Signatures). Under the current provision, "[c]ertificates for shares of capital stock of FINRA Regulation shall be signed in the name of FINRA Regulation by two officers with one being the Chair of the Board, the President, or a Vice President, and the other being the Secretary, the Treasurer, or such other officer that may be authorized by the Board." Under the proposal, certificates for shares of capital stock of FINRA Regulation shall be signed by two officers with one being the President or a Vice President, and the other being the Secretary, the Treasurer, or such other officer that may be authorized by the Board.

<sup>23</sup> See proposed FINRA Regulation By-Laws, Article XI, Section 11.3(b) (Signatures).



state of Delaware.<sup>25</sup> The proposal would delete as imprecise the words “certificates for” in the discussion of potential registration of shares of capital stock.<sup>26</sup>

#### Conforming Changes Relating to the New FINRA Name and Other Minor Changes

The proposed rule change would make certain non-substantive changes to Articles IV and XI of the FINRA Regulation By-Laws as follows:

- “the NASD” or “NASD” is replaced with “FINRA” or “the Corporation;”
- “NASD Regulation” is changed to “FINRA Regulation;”
- “the Rules of the Association” is replaced with “the Rules of the Corporation,” and
- “National Nominating Committee” is replaced with “Nominating Committee.”

The proposed rule change would update sections of the FINRA Regulation By-Laws to acknowledge current practices. Because the President of FINRA Regulation is not designated to be a Governor on the FINRA Board, the proposed rule change would delete several references to the President of FINRA Regulation.<sup>27</sup>

The proposed rule change would amend and eliminate exceptions to the statement in Section 4.3 that the Chief Executive Officer (“CEO”) of FINRA shall be an ex-officio non-

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<sup>24</sup> See current FINRA Regulation By-Laws, Article XI, Section 11.4(a) (Stock Ledger).

<sup>25</sup> See Delaware General Corporation Law § 158.

<sup>26</sup> See proposed FINRA Regulation By-Laws, Article XI, Sections 11.4(a) (Stock Ledger) and 11.5(a) (Transfers of Stock).

<sup>27</sup> See FINRA Regulation By-Laws, Article IV, Sections 4.3(a) (Qualifications), 4.5 (Resignation), 4.11(c) (Meetings), 4.13(f) (Executive Committee), and 4.13(g) (Finance Committee). Section 141(c)(2) of the General Corporation Law of the State of Delaware provides that “[t]he board of directors may designate 1 or more committees, each committee to consist of 1 or more directors of the corporation.” (Emphasis Added). Committees of the board, therefore, may be comprised exclusively of board members. In addition, any committee of the board that is delegated any power and authority of the board, such as the Executive Committee, must be comprised exclusively of board members. See Delaware General Corporation Law, § 141(c)(2).

voting member of the FINRA Regulation Board. In particular, the proposed rule change would eliminate the exception regarding the CEO of FINRA also serving as President of FINRA Regulation and retaining the power to vote, among other powers. The FINRA Regulation Board will operate without this exception.

The proposed rule change would revise Article IV, Section 4.12 (Notice of Meeting; Waiver of Notice) and Article XII, Section 12.3 (Waiver of Notice) to reflect advances in technology and the common usage of electronic transmission as a means of communication. In both these sections, FINRA intends “electronic transmission” to include email, text messages, and related technologies as well as facsimile, radio, cable, wireless, or telegraph. The proposal would make a related change to Article IV, Section 4.15 (Action Without Meeting) to eliminate the requirement that unanimous consent to taking action without a meeting specifically be in writing and filed with the minutes of the meeting. Instead, the consent would need to be “in accordance with” Delaware law, which allows a board to take action pursuant to unanimous consent communicated by electronic transmission.<sup>28</sup>

Furthermore, the proposed modifications also would delete as unnecessary the provision that allowed the advisory council to attend a FINRA Regulation Board meeting, but not to vote.<sup>29</sup>

Proposed Schedule A to the FINRA Regulation By-Laws would describe the boundaries for districts one through eleven. These boundaries are not changing. The description of district boundaries is being proposed for deletion as Schedule B from the FINRA By-Laws and is being proposed for addition as Schedule A to the FINRA Regulation By-Laws for administrative

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<sup>28</sup> See Delaware General Corporation Law, § 141(f).

convenience because the districts are established in Article VIII, Section 8.1 (Establishment of Districts) of the current FINRA Regulation By-Laws.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Regulatory Notice announcing Commission approval.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>30</sup> which requires, among other things, that FINRA rules must 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; and Section 15A(b)(4) of the Act,<sup>31</sup> which requires that FINRA rules be designed to assure a fair representation of FINRA's members in the administration of its affairs. The composition of the FINRA Board has previously been found to meet the statutory requirements, and FINRA believes that the proposed rule change will allow the representation of industry members, as well as public members, on the FINRA Regulation Board while enabling the FINRA Regulation Board to operate with a close connection to the FINRA Board. The remaining changes either conform to other changes made to the By-Laws or acknowledge current practices.

### B. Self-Regulatory Organization's Statement on Burden on Competition

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<sup>29</sup> See proposed FINRA Regulation By-Laws, Article VIII, Section 8.7(b) (Advisory Council).

<sup>30</sup> 15 U.S.C. 78o-3(b)(6).

<sup>31</sup> 15 U.S.C. 78o-3(b)(4).

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2009-020 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and

Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2009-020. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-020 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>32</sup>

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<sup>32</sup> 17 CFR 200.30-3(a)(12).

Florence E. Harmon  
Deputy Secretary