

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64363; File No. SR-FINRA-2011-011)

April 28, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Amend the By-Laws of FINRA Regulation, Inc. with Regard to District Committees

I. Introduction

On February 25, 2011, 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 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend the By-Laws of FINRA’s regulatory subsidiary (“FINRA Regulation”) with regard to District Committee structure and governance to, among other things, adjust the size and composition of District Committees to align more closely with the industry representation on the FINRA Board and replace District Nominating Committees with a process of direct nomination and election based on firm size. The proposed rule change was published for comment in the Federal Register on March 7, 2011.³ The Commission received one comment letter on the proposed rule change.⁴ FINRA responded to the Horwitz Letter on April 15, 2011.⁵ This order approves the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 64002 (March 2, 2011), 76 FR 12390 (“Notice”).

⁴ See letter from Ed Horwitz, District and Committee Member, Horwitz and Associates, Inc., to Commission, dated March 25, 2011 (“Horwitz Letter”).

⁵ See letter from John Komoroske, Vice President, Member Regulation, FINRA, to Elizabeth M. Murphy, Secretary, Commission dated April 15, 2011 (“FINRA Response”).

II. Background - District Committees, District Nominating Committees, Districts and Regions

Pursuant to the By-Laws, the FINRA Regulation Board of Directors determines the boundaries of the districts and the size of the District Committees. The FINRA Regulation Board has established eleven districts, overseen by FINRA District Offices, which are administratively grouped within five regions (the West, the Midwest, the South, the North and New York).

Currently, FINRA District Committee members contribute to the regulatory process by, among other things, serving as panelists in disciplinary proceedings in accordance with FINRA Rules; considering and recommending policies and rule changes; and endeavoring to educate FINRA members and others as to the objects, purposes and work of FINRA and FINRA Regulation. The District Committees meet on average twice each year, jointly with the other District Committees in their respective regions. District Committees are composed of nine members, with the exception of the New York District Committee which has twelve. Due to staggered three-year District Committee membership terms, one-third of each District Committee's positions are available for election each year. In some cases, a District Committee may have additional positions to fill if a member has died, resigned, or been removed creating a vacancy on the Committee.

The District Nominating Committees are composed of five members each, a majority of whom have served on a District Committee, are current or former FINRA Regulation Directors, or current or former FINRA Governors. As part of the election process, the By-Laws require the Corporate Secretary to provide each District Nominating Committee and District Director notice, on or before June 1 of each year, identifying the members of the District Committees and

District Nominating Committees whose terms are expiring within the next calendar year. After the vacancies are announced, any interested party may propose a candidate profile which will be used by the District Nominating Committees for review, a process that usually involves candidate interviews and that will conclude with the nomination of a slate of candidates for election. The By-Laws also provide a process whereby a registered person meeting the vacancy requirements may be considered for nomination as an additional (“petition”) candidate in a contested election. In recent years, FINRA has witnessed a decline in the number of eligible individuals willing to serve on the District or District Nominating committees or to undergo the nomination process. FINRA believes this decline is due to a number of perceived problems which FINRA seeks to address by streamlining the nomination and election process as described below.

III. Description of the Proposed Rule Change

FINRA proposed to modify the FINRA Regulation By-Laws (“By-Laws”) with regard to District Committees in several respects. FINRA proposed to:

- adjust the size and composition of District Committees over a three-year transition period to align more closely with the industry representation on the FINRA Board;
- replace District Nominating Committees with a process of direct nomination and election based on firm size;
- codify the current practice of District Committees meeting on a regional basis;
- eliminate the Advisory Council;
- amend the qualification requirements and prescribe further term limits for District Committee members;

- revise procedures for qualification and accounting of ballots to be administered solely by an Independent Agent; and
- make other procedural and administrative changes.

IV. Discussion of Comment Letter

As noted above, the Commission received one comment letter on the proposed rule change and FINRA responded to the comment.⁶ The commenter opposed the proposal for two reasons. First, the commenter states that the proposed rule change would give large firms disproportionate representation on the District Committees. The commenter notes that Large Firms make up 8.52 percent of FINRA's membership and employ 88.04 percent of the total registered representatives, while Small Firms make up 91.48 percent of FINRA's membership and employ 11.95 percent of the total registered representatives.⁷ Though the commenter acknowledges that large firms employ a significant majority of registered representatives, he notes that representatives do not count as members.

FINRA responded to the issues raised in the Horwitz Letter. FINRA believes that the proposed composition of the District Committees which is based on the size of firms will ensure fairness and balance between those firms that make up the largest percentage of membership and those firms that employ the largest percentage of the registered representative population. FINRA noted that three-sevenths of the District Committee members would be associated with Small Firms, one-seventh with Mid-Sized Firms and three-sevenths with Large Firms, as these terms are defined in FINRA's rules. FINRA believes that having representation on the District

⁶ See supra notes 4 and 5.

⁷ The commenter has combined the categories of Mid-Sized Firm and Large Firm. See Response letter at 2.

Committees of firms of different sizes should result in inclusion of firms having different business models, and more fully represent the interests of FINRA's diverse membership in committee discussions. FINRA further states that the proposed compositional structure of the District Committees is similar to the compositional structures of industry representatives on the FINRA Board of Governors and the National Adjudicatory Council ("NAC").

Second, the commenter questions the proposal to eliminate the District Nominating Committees and replace them with a process of self-nomination by individuals who meet the qualification requirements. The commenter believes that this proposed change will make the voting process a popularity contest rather than a selection by peers based on proven track records and industry background.

FINRA stated that it has witnessed a decline in the number of eligible individuals willing to serve on the District or District Nominating committees or to undergo the nomination process. In response, FINRA proposed to replace District Nomination Committees with a process of direct candidate nomination and election by the membership because FINRA believes the proposal will create a more accessible, transparent, and effective election process. Moreover, FINRA notes that the District Nominating Committees are made up of a majority of former District Committee members, or current or former Directors of the FINRA Regulation Board and Governors of the FINRA Board. FINRA stated that it intends to seek informal input from retiring District Committee members regarding potential future members, thus continuing to draw upon the expertise of this group, without the need and expense of the current District Nominating Committees.

V. Commission Findings

The Commission has carefully reviewed the proposed rule change, the comment letter, and FINRA's response to the comment, and believes that FINRA has appropriately responded to the commenter's concerns. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association, and, in particular, with the provisions of Section 15A(b)(6) of the Act,⁸ 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.⁹

The proposed rule change is designed to streamline the nomination and election process for District Committees, adjust the size and composition of District Committees, amend the qualification requirements, prescribe further term limits for District Committee members, and make other administrative and technical changes to the process, and should result in additional candidates willing to serve on a District Committee. The proposal aligns the representation of members on the District Committees to be generally consistent with the industry representation on the FINRA Board of Governors and the industry representation on the NAC. As FINRA stated in its Response Letter, three-sevenths of the District Committee members will represent Small Firms, one-seventh will represent Mid-Sized Firms and three-sevenths will represent Large Firms. FINRA's goal is to more closely align the membership of the District Committees

⁸ 15 U.S.C 78o-3(b)(6).

⁹ In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

with its membership while streamlining the process for finding and electing candidates to serve on the District Committee.

FINRA will prohibit a District Committee member from serving consecutive three-year terms to bring different perspectives and views to District Committees. Individuals interested in serving more than one term may do so on a non-consecutive basis. FINRA is eliminating the Advisory Council and will seek views on policy issues and recommendations directly from its membership. With these changes, the Commission believes that FINRA will be able to realize the goals of the District Committee system without the time and resource expenditures now required of Advisory Council members and FINRA staff. Further, centralizing the election process within the Corporate Secretary's office should streamline the process making it more efficient. The Corporate Secretary's office will be able to apply its administrative experience from other FINRA elections to the process for District Committee elections.¹⁰

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-FINRA-2011-011) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹²

Cathy H. Ahn
Deputy Secretary

¹⁰ FINRA will implement the proposal on the first day of the month following Commission approval.

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).